

**FINANCIAL STATUS OF THE PENSION BENEFIT
GUARANTY CORPORATION'S SINGLE EMPLOYER
INSURANCE PROGRAM**

HEARING
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

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FINANCIAL STATUS OF THE PENSION BENEFIT GUARANTY CORPORATION'S SINGLE EMPLOY- ER INSURANCE PROGRAM

TUESDAY, MARCH 20, 1984

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, D.C.

The subcommittee met at 10:15 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Charles B. Rangel (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

[Press release of Friday, Feb. 24, 1984]

HON. CHARLES B. RANGEL (D., N.Y.), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES HEARING ON THE FINANCIAL STATUS OF THE PENSION BENEFIT GUARANTY CORPORATION'S SINGLE EMPLOYER INSURANCE PROGRAM

The Honorable Charles B. Rangel (D., N.Y.), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, announced today that the Subcommittee will hold a public hearing to examine the financial status of the single employer pension plan termination insurance program in light of the Administration's request for an increase in the premium rate for the program. This mandatory insurance program is administered by the Pension Benefit Guaranty Corporation (PBGC) pursuant to Title IV of the Employee Retirement Income Security Act of 1974 (ERISA). The Subcommittee's hearing is being conducted at the request of the Honorable Dan Rostenkowski, Chairman of the Committee on Ways and Means, and as part of the Subcommittee on Oversight's ongoing review of the administration of provisions of ERISA. The hearing will be held on Tuesday, March 20, 1984, beginning at 10:00 a.m. in the Committee's Main Hearing Room, 1100 Longworth House Office Building.

Under ERISA, PBGC's single employer insurance program provides insurance protection for about 30 million participants in more than 106,000 private defined benefit pension plans. The single employer program is financed by per capita annual premiums from ongoing covered plans, assets from terminated plans, investment income, and amounts due PBGC from the sponsors of terminating plans (employer liability). Also, PBGC is authorized to borrow up to \$100 million from the U.S. Treasury.

Premiums are collected annually from plans based on the number of plan participants. The annual premium rate was originally set at \$1.00 per participant in 1974 and was increased to \$2.60, effective January 1, 1978.

Because liabilities assumed under terminated plans exceed income from all sources, PBGC has a growing deficit that is expected to reach \$622 million by the end of 1985 under current law. In May, 1982, PBGC submitted to the Congress a request for a premium rate increase to \$6.00 per plan participant for plan years commencing on or after January 1, 1983.

The FY 1985 budget reflects the Administration's request that Congress approve an increase in the single employer premium rate to \$7.00 to cover projected claims and amortize the current deficit over time. The increased rate would be effective for plan years beginning on or after January 1, 1984. The Administration estimates

that PBGC's outlays would be reduced by \$101 million in fiscal year 1984, \$154 million in fiscal year 1985, \$168 million in fiscal year 1986 and \$199 million for fiscal year 1987.

Testimony will be received from the Pension Benefit Guaranty Corporation, the General Accounting Office and from invited and public witnesses.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler ((202) 225-3627) no later than close of business, Friday, March 9, 1984, to be followed by a formal written request to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesman to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This process will afford more time for members to question witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 100 copies of their prepared statements to the full Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

Requests to be heard must contain the following information:

1. The name, full address, and capacity in which the witness will appear as well as a telephone number where he or his designated representative may be reached.
2. A list of any clients or persons, or any organization for whom the witness appears; and
3. A topical outline or summary of comments and recommendations.

The above information should also be incorporated in the prepared statements to be presented in person as well as those filed for the printed record of the hearing.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

Persons submitting a written statement in lieu of a personal appearance should submit at least six (6) copies of their statement by the close of business, Friday, March 30, 1984, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may provide 75 additional copies for this purpose to the full Committee office before the hearing begins.

Chairman RANGEL. Good morning.

The Subcommittee on Oversight of the Committee on Ways and Means will come to order.

This hearing is being held today at the request of the chairman of the Committee on Ways and Means, Dan Rostenkowski, to examine the financial condition of the single employer pension plan termination insurance program.

This mandatory insurance program was established by ERISA almost 10 years ago and is administered by the Pension Benefit Guaranty Corporation. The program is financed primarily by per capita premiums paid by covered employers sponsoring defined benefit plans. The current premium rate, originally set at \$1, is now \$2.60 per plan participant.

The administration's fiscal year 1985 budget states that because liabilities assumed under terminated plans exceed income from all sources, PBGC has a growing deficit that is expected to reach \$622

million by the end of 1985 unless action is taken now. The fiscal year 1985 budget reflects the administration's request that the Congress approve an increase in the single employer pension premium rate to \$7, effective for plans years beginning on or after January 1, 1984.

The subcommittee is seeking to analyze the financial condition of the single employer insurance program in light of the administration's premium rate increase request. We want to know why there is a deficit, its component parts, and why a premium increase is considered necessary. Also, we are interested in knowing the consequences of a premium increase or other program changes on defined benefit plans, on employers, and on the pension security of plan participants and their beneficiaries.

I welcome all the witnesses here today. I appreciate your taking the time to assist the subcommittee in finding answers to these questions. These answers are of the utmost importance to all of us who maintain defined pension plans, who rely on this program for protection of their hard-earned retirement income, as well as those who seek to encourage the maintenance and growth of a strong private pension system in our Nation.

As the witnesses know, there is concurrent jurisdiction over this subject matter with the Education and Labor Committee. And, while we here are concerned with the tax aspects, I think that most people who agree that we have to do something to increase the premium have also conditioned that increase on some type of reform in the system to make certain that there is not an undue burden on employers that act in a more responsible way than others. To that extent, since this legislation will be following two tracks, it will be just as important to the members of this panel to hear testimony as it relates to what legislative recommendations are being made in terms of reform, as well as the need for this very substantial increase in premium.

So I yield to my friend Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

I actually have no opening statement, other than to commend you for scheduling these hearings. I know there are a lot of questions that we need the answers to concerning this very important and vital program. So I am looking forward to getting them.

We have good panels throughout the day, and we will be delighted to hear them.

Chairman RANGEL. Our first witness will be Charles Tharp, Executive Director of the PBGC.

It is my understanding that you know the thrust of the concerns of the Congress as evidenced through this subcommittee, and we do have a copy of your prepared statement which, without objection, will be entered into the record.

You may read the statement or you may highlight the statement as you see fit.

Thank you for appearing this morning.

STATEMENT OF CHARLES C. THARP, EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION, ACCOMPANIED BY DAVID WALKER, DEPUTY EXECUTIVE DIRECTOR FOR INSURANCE PROGRAMS; AND JOHN HIRSCHMANN, CHIEF, FINANCIAL ANALYSIS

Mr. THARP. Thank you, Mr. Chairman.

Let me introduce two people who are here with me this morning; our Deputy Executive Director for Insurance Programs David Walker, and our Chief of Financial Analysis John Hirschmann.

I am pleased to be here today to testify on behalf of the administration in support of comprehensive legislation, including an increase in the premium charged for single-employer—

Chairman RANGEL. Excuse me, Mr. Director. Would you try to talk more directly into the mike?

Mr. THARP. Is that a little better?

Chairman RANGEL. It is.

Mr. THARP. In support of comprehensive legislation, including an increase in the premium charged for single-employer plans to \$7 from the current rate of \$2.60, and legislative changes in the single-employer program to diminish abuses under title IV of ERISA.

The PBGC is a self-financing, wholly owned Government corporation which was established in 1974 by ERISA. The termination insurance program was intended to guarantee a basic level of benefits in terminating private defined benefit pension plans, and thus to protect the 38 million participants in such plans, including over 29 million in single-employer plans.

At the program's inception, the annual premium set by Congress was \$1 per participant. In the first 2½ years of the Corporation's existence, the average annual claims against the system totaled about \$25 million, and the average individual claim was about \$300,000.

By September 1976, PBGC already was operating with a deficit of \$41 million. In response to PBGC's growing concerns with respect to financing the costs of the program, Congress raised the premium in December 1977 to \$2.60, effective for plan years commencing on or after January 1, 1978.

That premium proved inadequate. As of September 30, 1981, the deficit stood at about \$189 million, the average annual claims against the program were about \$65 million, and the average individual claim about \$1 million. Accordingly, in May 1982, PBGC sought a premium increase to \$6, which at the time would have covered expected future claims and administrative expenses, and was projected to retire the deficit in 5 years.

During the latter part of fiscal 1982, however, PBGC experienced some of the largest terminations in its history. As a result, claims for fiscal year 1982 totaled about \$220 million, far in excess of projections.

Chairman RANGEL. Do you later in your testimony go into the causes of those terminations?

Mr. THARP. I could interject at this time that I think it is correlative to the recession and the general economy, and certainly the

large terminations that we experienced would appear to have been thus related.

Chairman RANGEL. I ask you to consider that answer in connection with the positive expectations of the administration in the recovery.

Mr. THARP. It would have required about \$7 for each of the over 29 million insured participants to fully fund just those 1982 claims.

At the end of that fiscal year, PBGC's deficit was \$333 million. Since then, in the absence of the requested increase, the program's financial condition has worsened significantly. Our preliminary estimate is that as of September 30, 1983, the deficit has grown to over \$450 million, which is about double the deficit underlying our 1982 request for a \$6 premium.

We currently project that without a premium increase the deficit will be more than about \$550 million by the end of this fiscal year, and it will mushroom to over \$1.1 billion by the end of fiscal year 1988.

The administration feels strongly that it would be neither prudent nor fiscally responsible for the corporation to experience deficits approaching this magnitude.

When it became clear in late 1983 that no premium increase would be enacted for the 1983 plan year, a loss of \$100 million in revenues for the corporation, PBGC reviewed its previous premium study in the context of the most recent financial data available.

Using the assumption that the unusually high level of losses that occurred in fiscal year 1982 could be reasonably expected to occur about once every 8 years, and accordingly, revising our projection of claims for fiscal 1983 to \$105 million, we now project annual average claims for fiscal years 1984 to 1988 at \$136 million, which represents a growth rate of about \$10 million, or about 8 percent per year.

With the further projection of the deficit in the single-employer plan program at \$462 million as of January 1, 1984, we now project that a premium level of \$7 would be necessary to retire the deficit in 15 years. We are requesting a premium increase to \$7, recognizing that larger than expected losses in the future could prevent retirement of the deficit at this premium level. An increase in the single-employer premium to \$7 per participant is necessary to finance expected future claims, cover administrative expenses, and to work toward retiring the deficit.

This premium level is based on fairly optimistic assumptions. It assumes no extraordinarily large claims in the calculation of expected annual losses, and it makes no provision for establishing a reserve or surplus for extraordinarily large claims. It also assumes continuation of the historical growth rate in covered participants of 1.1 million per year.

And more significantly, it rests critically on the assumption that the increase will be effective for the 1984 plan years beginning on or after January 1, 1984. Any later effective date would delay the increased premium until 1985 for calendar year plans, which comprise over 70 percent of participants covered by the insurance system. If no increase is effective until January 1, 1985, PBGC's request would have to be increased to over \$7.50.

The Corporation's current request is based on the premise that PBGC's claims would be currently funded rather than funded on a pay as you go basis. This means that the corporation should have on hand at any point in time assets which, together with the return that can be achieved on their investment, will be sufficient to pay all liabilities assumed at that time.

PBGC has obligated itself to pay benefits over the future in the amount of about \$4 billion. At the current time its assets are only slightly in excess of \$1 billion. Thus, our current financial condition is untenable, and it is worsening.

In fiscal year 1982, the total benefits paid to participants and beneficiaries in terminated single-employer plans exceeded for the first time in PBGC's history our premium revenues. PBGC is currently paying about \$150 million a year in benefits, almost twice the amount of revenue it receives.

Based on projected benefit payments, administrative expenses and premium income, and assuming a 10-percent return on investments, the single-employer program will have a negative cash flow this year. As a result, for the first time, beginning late in this fiscal year, or in fiscal year 1985, the PBGC would add to the federal deficit, not defray it, unless the \$7 premium is enacted.

If the present trend is allowed to continue, PBGC will find itself in the same disastrous condition with the same attendant policy predicament as Congress recently faced with the social security system.

The \$7 premium allocates \$4.50 to finance expected future claims, \$1.50 toward retirement of the deficit, and \$1 for administrative expenses of the Corporation. The \$1 allocation to administrative expenses reflects the fact that PBGC has held its administrative costs to a minimum. Our administrative overhead per participant is decreasing steadily, and our fiscal year 1985 budget request is \$1.7 million below our fiscal year 1984 budget.

PBGC has not increased its authorized personnel level in its last three budget submissions. We have put in place various programs to increase administrative efficiency. One of these programs, project computers, focuses on the development of a system that will permit recordkeeping, data processing, and financial management to be performed through an integrated data base, thus eliminating duplicate recordkeeping and data processing while consolidating what in the past has comprised over 50 individual systems.

Our optimal projection of cumulative savings is over \$5 million for fiscal years 1985 through 1989 in this program. In addition, the structure of the Corporation has been reorganized to better handle an increasing volume of business at the lowest cost consistent with quality service.

Thus, PBGC is making every internal effort possible to support the termination insurance program at the lowest possible cost. Its continued viability depends at this juncture on a premium increase to \$7 effective for plan years beginning in 1984. In addition, there are certain legislative changes which we view as essential.

It is the administration's strongly held view that a premium increase alone is inadequate to protect the insurance system over the long term. There are other legislative changes necessary to prevent abuse of the program and to clarify what we believe to be Congress

original intent that ongoing employers not be permitted to shift liability onto premium payers as a whole.

Under current law, the insurable event is voluntary termination by a plan sponsor rather than termination resulting from an employer's financial inability to maintain the plan. Thus because generally an employer may terminate its plan at any time, PBGC cannot prevent a termination which is timed to coincide with a period when 30 percent of an employer's net worth falls drastically short of the unfunded guaranteed benefits in the plan.

We believe that it is only reasonable that an ongoing employer pay for the unfunded benefits in its plan from its future profits instead of allowing that employer to manipulate the termination in order to avoid responsibility altogether.

Under the legislative proposal we advocate, PBGC would guarantee benefits in a plan terminated by an ongoing employer only if we determine that the employer is truly in financial distress, and then only if an arrangement is concluded which would enable the corporation to recover, in cash, as of the date of termination, unpaid contributions to the plan and 30 percent of the employer's net worth, as well as a profits interest in the employer to repay the remaining unfunded benefits over a period not to exceed 10 years.

We recognize that the \$150 million in losses that the PBGC has incurred through fiscal year 1982 as a result of employer liquidations cannot and should not be avoided by the insurance system. However, PBGC has absorbed losses of over \$140 million from ongoing employers which are not in any type of bankruptcy proceeding or liquidation process.

In addition, about \$295 million of losses have occurred in situations where the employer was in reorganization proceedings, and our recovery in those situations has been equal to only 6 percent of the losses incurred for such cases. We believe that legislative changes along the lines we propose would improve our recoveries in these situations and thus not penalize other employers who have maintained their plans on a well-funded basis.

The administration further recommends a change in the definition of employer for liability purposes so that all entities in common control with the plan sponsor, based on a common interest in excess of 50 percent, would share in the responsibility for the plan's underfunding.

A 50 percent interest in a business provides effective control. It is unreasonable for controlled group members with more than a 50 percent interest in a plan sponsor to avoid all the responsibility for that sponsor's pension plan by shifting the obligation to fund guaranteed benefits to other PBGC premium payers who have no connection with the terminating plan.

The 80 percent common control test presently in ERISA derives from the tax law limitations on multiple tax benefits for controlled groups based on 80 percent control. There is no necessary or logical tie between the 80 percent tax law test for common control and the common control test for liability to PBGC under ERISA.

In addition, an 80 percent test creates an incentive for manipulation. An employer should not be permitted to limit the PBGC's recovery simply by lowering its interest in a profitable entity to a

level just under 80 percent, the current test for common control, while maintaining effective control over that entity.

Under our proposal, plan sponsors would still be able to terminate plans that have sufficient assets to fully fund guaranteed benefits without requiring any negotiations with the PBGC. In addition, the right of an employer to freeze its plan and cease benefit accruals would not be altered, so that an employer could, without PBGC involvement, eliminate its annual cost for funding benefit accruals in current and future years.

A third source of losses for the PBGC has come from the minimum funding waivers granted by the Internal Revenue Service. Minimum funding waivers are granted by the IRS where an employer can demonstrate hardship, that is, that its financial difficulties prevent it from making the required contribution to the plan in that year. Even where a condition is placed on the waiver making it due and owing on plan termination, the plan is at best a general, unsecured creditor, and its recovery is apt to be small.

The administration believes that waivers should be granted only under conditions that will give the plan at the time the waiver is granted the same protection that a bank or insurance company lender would require when credit is extended.

To achieve this result, we propose that a general lien arise in favor of the plan at the time a waiver is granted which survives until the waived amounts are paid fully to the plan or until other security interests are provided to the plan. It was never intended that plans be used by financially troubled employers as the least expensive bank available.

We expect this practice to be significantly reduced under our proposal, and obviously if the plan is protected by a lien or collateral, PBGC will be protected should the plan terminate before the waived amounts are repaid.

Moreover, any provision should avoid the possibility of placing the plan administrator in the position where he or she may be required to make a decision with respect to securing the plan which affects nonplan interests. Thus, in most cases, the PBGC rather than the plan administrator would make the decision to perfect the lien.

Transfers. Another major source of losses to the system is caused by abusive transfers of liability. We do not think that such transfers are within the intention of current law. Accordingly, we believe that Congress should adopt explicit statutory language in title IV to underscore that such transfers are unlawful.

Thus, our proposal would create contingent liability where an employer spins off a portion of the business with substantial unfunded liabilities, leaving a weaker plan sponsor to fund the benefits, or an employer sells off losing operations, with their associated underfunded plans, to newly formed or highly leveraged companies, thereby shedding liabilities for benefits which accrued while the old employer sponsored the plan. Unless this abuse is explicitly outlawed, the possibility is very real that our already large losses from such transactions will escalate.

The appropriate period of contingent liability has been much debated over the last few years. We believe that a paramount concern in addressing this issue is whether the time period chosen is

long enough to discourage a transferor from keeping a weak transferee afloat where the costs of such a course would be less expensive than the amount of contingent liability involved.

The greater the liability transferred, the more incentive there is for a transferor to carry the transferee, either through direct credit arrangements or the securing of outside credit by the transferor for the transferee. In our view, while a period of 5 years may, in some cases, be adequate, a 10-year period for contingent liability is essential where the amount of unfunded liability transferred exceeds \$10 million.

We have no intention of discouraging normal business transactions or even transactions designed to rescue troubled operations. It is our view, however, that the cost of funding those liabilities should not be allowed to fall on other premium payers when the transferred operations fail.

Similarly, an arbitrary percentage test for common control should not be allowed to bring about this result, nor should a strong company be allowed to manipulate ownership in a weak company in order to protect its assets against controlled group liability.

Transfers which do not pose a significant risk to the system would be exempted, such as those where the liability transferred is small or where the new employer is at least as strong as the old or is strong enough to fund the plan.

With these legislative changes and the requested increase in the premium level, Mr. Chairman, we have every reason to expect that the insurance program will be placed on a sound financial footing not subject to the abuse of a few employers at a cost to the vast majority of premium payers.

On behalf of the administration, I strongly urge immediate consideration of these proposals before the costs of insuring private pension benefits simply becomes too great to support.

Thank you, Mr. Chairman.

Chairman RANGEL. Thank you.

Let me congratulate you, Mr. Tharp, for proposing a set of legislative reform recommendations as well as including that with your request for a premium increase. I congratulate you because while everyone generally supports that something has to be done, this is the first time, I think, that it has been placed before members of Congress in specific terms by the PBGC.

So let me ask, in order to set a record as to how much of a problem is before the subcommittee, when you referred to the administration, you were talking about the administration of the PBGC, correct?

Mr. THARP. In one portion of my testimony I referred to administration internal to the PBGC. In terms of the legislative changes, this proposal is supported by the administration with a capital "A".

Chairman RANGEL. Well, how about the Reagan administration?

Mr. THARP. That is the one.

Chairman RANGEL. And OMB and the Secretary of Labor and the Secretary of the Treasury?

Mr. THARP. That is correct.

Chairman RANGEL. They are not only supporting the premium increase but also the reform part of your package?

Mr. THARP. That is correct.

Chairman RANGEL. Now, have you attempted to get support from management, the chamber, and labor, the unions, on the reform part of your package. And if so, what degree of support do you enjoy in those areas?

Mr. THARP. I am very pleased to say that we have had ongoing discussions with the various parties who are close to this issue and most affected by it, and I think that we have gotten to the point where we are 95 percent of the way in terms of having a common understanding as to what is necessary here.

I will not steal their thunder because I know that some of these groups are speaking before us a little later, but I am very pleased at the distance they have come toward reaching an accord on this.

Chairman RANGEL. Now, the optimistic projections you have as relate to the economy, do they coincide with the projections that are made by the current administration?

Mr. THARP. Well, I would have to say this, that our premium projections and the numbers on which we based the \$7 request are not directly tied to any external macroeconomic economic projection. Instead, they are based simply on our own experience over the last 8 years.

Thus, for instance, we project that once every 8 years there will be a year as bad as the 1982 year in which we experienced \$220 million in losses.

Chairman RANGEL. Well, when I interrupted you when you were making your presentation, you had indicated that the historic increase in terminations was primarily due to the recession.

What percentage of the terminations or the liabilities of the Corporation are based on economic conditions and what percentage would you say are based on abuse of the program? And could you give us figures for 1982 and 1983 as to what the liabilities were and what percentage of those liabilities were based on irresponsible employers and what percentage was actually based on the economy?

Mr. THARP. Well, to place it in perspective, what we would project as a normal level of claims over the next several years would be an average of \$140 million a year. For 1982, PBGC projected losses of approximately \$80 million; our actual losses reached \$220 million, about \$140 million in excess of our projections. As I say, that appears to coincide with the worst year of the recession, and thus to the extent there is any correlation with macroeconomic factors, that may be it.

Chairman RANGEL. Could you give us the liabilities for 1982?

Mr. THARP. Yes. The losses for 1982 were about \$220 million, and the deficit for 1982 at fiscal year end was \$330 million.

Chairman RANGEL. In 1983?

Mr. THARP. In 1983 we project in excess of \$430 million.

Chairman RANGEL. And what percentage roughly would you say of that liability is due to abuse?

Mr. THARP. Well, it is very difficult to quantify which particular abuses relate to which particular numbers.

Chairman RANGEL. Well, in terms of the reform legislation, how much savings do you think that we would have that you would attribute to the reform as opposed to the economy?

Mr. THARP. Let me give some illustrative figures with relation to a particular area of abuse that we are very much concerned about, the transfer rule.

We have experienced losses owing to the loopholes that are received to exist there of about \$105 million since the inception of the program. So you could say that \$105 million out of our total losses relates to that particular abuse alone.

I think that we could provide for the record additional figures which would relate to the other items on our list.

Chairman RANGEL. I wish you would because we are going to have to have a good selling job on reform if we are going to stand behind the substantial increase in premium.

Mr. THARP. May I say, Mr. Chairman, that the \$7 premium does assume that those abuses will not escalate in the future. So if there were legislation which did not include some of these items in the package, we would have to be looking at a premium that was higher than \$7 per year.

Chairman RANGEL. Well, I think you can be assured that if we accept the \$7 figure, it will include reform—if we accept that.

Mr. THARP. Thank you.

Chairman RANGEL. Tell me, were you preparing a report to show how the premiums relate to risk that address many of the arguments that we hear that employers should not all be treated the same way—are you preparing a study? Has that been completed?

Mr. THARP. Yes, Mr. Chairman. Under section 412 of the Multi-employer Act of 1980, we were given the charge of preparing a report on risk-related premium. That report is in its final stages now and is before our board of directors for review. While it is in the process of finalization, I do not feel that I can give you what its final recommendations would be, but I would be happy to submit that report for the record when it is completed and approved because I think that process will be concluded very shortly.

Chairman RANGEL. How long has it been completed?

Mr. THARP. Well, I hesitate to call it complete until——

Chairman RANGEL. How long has it been under review?

Mr. THARP. We have had it under review for the past several weeks during the normal review process among the various parties involved.

Chairman RANGEL. Well, you should appreciate that this is an urgent matter for employers, employees, the Congress and the Nation, and certainly your Corporation, and we will need as much information as you have.

So I do hope that you will ask your corporation to release, approved or unapproved, the data that cannot be disputed so that we can include that. If you have a problem in submitting it for our record, afterward——

Mr. THARP. We will be happy to submit it for the record when it is completed and approved, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF CHARLES C. THARP, EXECUTIVE DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION

Good Morning, Mr. Chairman and members of the Subcommittee. I am Charles C. Tharp, Executive Director of the Pension Benefit Guaranty Corporation and I am pleased to be here today to testify on behalf of the Administration in support of comprehensive legislation, including an increase in the premium charged for single-employer plans to \$7.00 from the current rate of \$2.60 and legislative changes in the single-employer program to diminish abuses under Title IV.

The PBGC is a self-financing, wholly owned government corporation which was established in 1974 by Title IV of ERISA. The termination insurance program was intended to guarantee a basic level of benefits in terminating private defined benefit pension plans, and thus to protect the 38 million participants in such plans, including over 29 million in single-employer plans.

At the program's inception, the annual premium set by Congress was \$1 per participant. In the first two and a half years of the Corporation's existence, the average annual claims against the system totalled about \$25 million and the average individual claim was about \$300,000. By September 1976, PBGC already was operating with a deficit of \$41 million. In response to PBGC's growing concerns with respect to financing the costs of the program, Congress raised the premium in December 1977 to \$2.60, effective for plan years commencing on or after January 1, 1978.

That premium proved inadequate. As of September 30, 1981, the deficit stood at about \$189 million, and the average annual claims against the program were about \$65 million and the average individual claim about \$1 million. Accordingly, in May 1982, PBGC sought a premium increase to \$6.00, which at the time would have covered expected future claims and administrative expenses, and was projected to retire the deficit in five years.

During the latter part of Fiscal 1982, however, PBGC experienced some of the largest terminations in its history. As a result, claims for Fiscal 1982 totalled about \$200 million, far in excess of projections. It would have required about \$7 for each of the over 29 million insured participants to fully fund the 1982 claims. As of September 30, 1982, PBGC's deficit was \$333 million, and in the absence of the requested increase, the program's financial condition has worsened significantly. Our preliminary estimate is that as of September 30, 1983, the deficit has grown to over \$430 million, which is about double the deficit underlying our 1982 request for a \$6.00 premium. We currently project that the deficit will be about \$550 million by the end of this fiscal year, and without a premium increase, it will mushroom to over \$1.1 billion by the end of Fiscal 1988. The Administration feels strongly that it would be neither prudent nor fiscally responsible for the Corporation to experience deficits approaching this magnitude.

When it becomes clear in late 1983 that no premium increase would be enacted for the 1983 plan year, a loss of \$100 million in revenues for the Corporation, PBGC reviewed its previous premium study in the context of the most recent financial data available. Using the assumption that the unusually high level of losses that occurred in Fiscal 1982 could reasonably be expected to occur once every eight years, and accordingly revision our projection of claims for Fiscal 1983 to \$105 million, we now project annual average claims for Fiscal Years 1984-88 at \$136 million. This represents a growth rate of about \$10 million or 8% per year.

With the further projection of the deficit in the single-employer plan program at \$462 million as of January 1, 1984, we now project that a premium level of \$7 would be necessary to retire the deficit in 15 years. We are requesting a premium increase to \$7.00, recognizing that larger than expected losses in the future could prevent retirement of the deficit at this premium level. An increase in the single-employer premium to \$7 per participant is necessary to finance expected future claims, to cover administrative expenses, and to work toward retiring the deficit.

This premium level is based on fairly optimistic assumptions. It assumes no extraordinarily large claims in the calculation of expected annual losses and it makes no provision for establishing a reserve or a surplus for extraordinarily large claims. It also assumes continuation of the historical growth rate in covered participants of 1.1 million per year. More significantly, it rests critically on the assumption that the increase will be effective for the 1984 plan year, that is, effective for plan years beginning on or after January 1, 1984. Any later effective date would delay the increased premium until 1985 for calendar year plans, which comprise over 70% of participants covered by the insurance system. If no increase is effective until January 1, 1985, PBGC's request would have to be increased to over \$7.50.

The Corporation's current request is based on the premise that PBGC's claims should be "currently funded" rather than funded on a "pay as you go" basis. This

means that the Corporation should have on hand at any point in time, assets which, together with the return that can be achieved on their investment, will be sufficient to pay all liabilities assumed at that time. PBGC has obligated itself to pay benefits over the future in the amount of about \$4 billion; at the current time, its assets are only slightly in excess of \$1 billion. Our current financial condition is untenable, and it is worsening.

In Fiscal Year 1981, the total benefits paid to participants and beneficiaries in terminated single-employer plans exceeded, for the first time in PBGC's history, our premium revenues. PBGC is currently paying about \$150 million a year in benefits, almost twice the amount of revenue it receives.

Based on projected benefit payments, administrative expenses and premium income, and assuming a 10 percent return on investments, the single employer program will have a negative cash flow late this Fiscal Year. As a result, for the first time, beginning in this Fiscal Year or Fiscal Year 1985, the PBGC would add to the federal deficit, not defray it, unless the \$7.00 premium is enacted. If the present trend is allowed to continue, PBGC will find itself in the same disastrous condition with the same attendant policy predicament as Congress recently faced with the Social Security system.

The \$7 premium level allocates \$4.50 to finance expected future claims, \$1.50 toward retirement of the deficit, and \$1.00 for administrative expenses of the Corporation in connection with the processing of all plan terminations, collection of liability and the payment of benefits. The \$1.00 allocation to administrative expenses reflects the fact that PBGC has held its administrative costs to a minimum. Our administrative overhead per participant is decreasing steadily, and our Fiscal Year 1985 budget request is \$1.7 million below our Fiscal Year 1984 budget. PBGC not increased its authorized personnel level in its last three budget submissions and has put in place various programs to increase administrative efficiency. One of these programs, "Project Computers", focuses on the development of a system that will permit recordkeeping, data processing, and financial management to be performed through an integrated data base, thus eliminating duplicate recordkeeping and data processing while consolidating what, in the past, has comprised over 50 individual systems. Our optimal projection of cumulative savings is over \$5 million for Fiscal Years 1985-89. In addition, the structure of the Corporation has been reorganized to better handle an increasing volume of business at the lowest cost consistent with quality service and proper utilization of personnel.

Thus, PBGC is making every internal effort possible to support the termination insurance program at the lowest possible cost. Its continued viability depends, however, at this juncture, on a premium increase to \$7.00 effective for 1984 plan years. In 1974, Congress assured American workers that their retirement benefits would be guaranteed if their pension plans should prove insufficient to pay them. Without a premium increase now, that assurance may become an empty promise.

LEGISLATIVE CHANGES

It is the Administration's strongly held view that a premium increase alone is inadequate to protect the insurance system over the long term. There are other legislative changes necessary to prevent abuse of the program and to clarify what we believe to be Congress' original intent that ongoing employers not be permitted to shift liability onto premium payers as a whole. Under current law, the insurable event is voluntary termination by a plan sponsor, rather than termination resulting from an employer's financial inability to maintain the plan. Thus, because an employer may terminate its plan at any time, PBGC cannot prevent a termination which is timed to coincide with a period when thirty percent of an employer's net worth falls drastically short of the unfunded guaranteed benefits in the plan. We believe that it is only reasonable that an ongoing employer pay for the unfunded benefits in its plan from its future profits, instead of allowing that employer to manipulate the termination in order to avoid responsibility altogether.

Under the legislative proposal we advocate, PBGC would guarantee benefits in a plan terminated by an ongoing employer only if we determine that the employer is truly in financial distress, and then, only if an arrangement is concluded which would enable the Corporation to recover, in cash as of the date of termination, unpaid contributions to the plan and 30 percent of the employer's net worth, as well as a profits interest in the employer to repay the remaining unfunded benefits over a period not to exceed ten years.

We recognize that the \$150 million in losses that the PBGC has incurred through Fiscal 1982 as a result of employer liquidations cannot and should not be avoided by the insurance system. However, PBGC has absorbed losses of over \$140 million from

ongoing employers which are not in any type of bankruptcy proceeding or liquidation process. In addition, about \$295 million of losses have occurred in situations where the employer was in reorganization proceedings, and our recovery in those situations has been equal to only 6 percent of the losses incurred for such cases. We believe that legislative changes along the lines we propose would improve our recoveries in these situations.

DEFINITION OF "EMPLOYER" UNDER TITLE IV

The Administration further recommends a change in the definition of "employer" for liability purposes so that all entities in common control with the plan sponsor, based on a common interest of 50 percent, would share in the responsibility for the plan's underfunding. An interest in a business of more than fifty percent provides effective control. It is unreasonable for controlled group members with more than 50 percent interest in a plan sponsor to avoid all responsibility for that sponsor's pension plan by shifting the obligation to fund guaranteed benefits to other PBGC premium payers. The 80 percent common control test in the tax code derives from the tax law limitations on multiple tax benefits for controlled groups based on 80 percent control. There is no necessary or logical tie between the 80 percent tax law test for common control and the common control test for liability to PBGC under ERISA. In addition, an 80 percent test creates an incentive for manipulation. An employer should not be permitted to limit the PBGC's recovery simply by lowering its interest in a profitable entity to a level just under 80 percent, the current test for common control, while still maintaining effective control over that entity.

Plan sponsors would still be able to terminate plans that have sufficient assets to fully fund guaranteed benefits, without requiring negotiations with the PBGC. In addition, the right of an employer to freeze its plan and cease benefit accruals would not be altered, so that an employer could, without PBGC involvement, eliminate its annual cost for funding benefit accruals in current and future years.

MINIMUM FUNDING WAIVERS

Another source of losses for the PBGC has come from the minimum funding waivers granted by the Internal Revenue Service. Minimum funding waivers are granted by the IRS where an employer can demonstrate hardship, i.e., that its financial difficulties prevent it from making the required contribution to the plan in that year. Even where a condition is placed on the waiver, making it due and owing on plan termination, the plan is at best a general unsecured creditor and its recovery is apt to be small. The Administration believes that waivers should be granted only under conditions that will give the plan, at the time the waiver is granted, the same protection that a bank or insurance company lender would require when credit is extended. To achieve this result, we suggest that a general lien arise in favor of the plan at the time a waiver is granted, which survives until the waived amounts are paid fully to the plan, or until other security interests are provided to the plan. It was never intended that plans be used by financially troubled employers as the least expensive bank available. We expect this practice to be significantly reduced under our proposal, and obviously, if the plan is protected by a lien or collateral, PBGC will be protected should the plan terminate before the waived amounts are repaid. Moreover, any provision should avoid the possibility of placing the plan administrator in the position where he or she may be required to make a decision with respect to securing the plan which affects non-plan interests. Thus, in most cases, the PBGC rather than the plan administrator, would make the decision to perfect the lien.

TRANSFERS

A third major source of losses to the system is caused by abusive transfers of liability. We do not think that such transfers are within the intention of current law, and accordingly, we believe that Congress should adopt explicit statutory language in Title IV to underscore that such transfers are unlawful. Thus, our proposal would create contingent liability where an employer spins off a portion of the business with substantial plan liabilities, leaving a weaker plan sponsor to fund the benefits, or an employer sells off losing operations, with their associated underfunded plans to newly formed or highly leveraged companies, thereby shedding liabilities for benefits which accrued while the old employer sponsored the plan. Unless this abuse is explicitly outlawed, the possibility is very real that our already large losses from such transactions will escalate.

The appropriate period of contingent liability has been much debated over the last few years. We believe that a paramount concern in addressing this issue is whether the time period chosen is long enough to discourage a transferor from keeping a weak transferee afloat, where the costs of such a course would be less expensive than the amount of contingent liability involved. The greater the liability transferred, the more incentive there is for a transferor to "carry" the transferee, either through direct credit arrangements, or the securing of outside credit by the transferor for the transferee. In our view, while a period of five years may, in some cases, be adequate, a ten year period for contingent liability is essential where the amount of unfunded liability transferred exceeds \$10 million.

We have no intention of discouraging normal business transactions, or even transactions designed to rescue troubled operations. It is our view, however, that the cost of funding those liabilities should not be allowed to fall on other premium payers when the transferred operations fail. Similarly, an arbitrary percentage test for common control should not be allowed to bring about this result. Nor should a strong company be allowed to manipulate ownership in a weak company in order to protect its assets against controlled group liability. Transfers which do not pose a significant risk to the system would be exempted, such as those where the liability transferred is small, or where the new employer is at least as strong as the old, or is strong enough to fund the plan.

With these legislative changes, and the requested increase in the premium level, we have every reason to expect that the insurance program will be on a sound financial footing, not subject to the abuse of a few employers at a cost to the vast majority of premium payers. On behalf of the Administration, I strongly urge immediate consideration of those proposals, before the costs of insuring private pension benefits simply becomes too great.

Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Gibbons.

I have other questions, but I want to make sure my colleagues have an opportunity.

Mr. GIBBONS. Well, first of all, Mr. Chairman, let me thank you for your intelligent questions.

I have somewhat of a guilty conscience about this. I took part in the birthing of the Pension Benefit Guaranty Corporation, and I have followed its operations over a number of years.

But I must say I have really had some second thoughts about the whole concept, as to whether it was a good concept or not. It seems to me that what we are doing is we are taxing the successful people in our society to prop up all those unsuccessful managers who have made sloppy decisions, and I am not sure if that is best for the United States.

It looks like we are going to heap more and more taxes on them. I remember when we first talked about PBGC, we were talking about a 50-cent-a-year tax. Apparently we finally settled at \$1, and now we are increasing it to \$7. Where do we go from \$7?

Mr. THARP. Sir, I hope that we get these abuses taken care of, loopholes plugged, and that \$7 would be a premium that we would be able to live with for many years, and perhaps we may even find in our experience that the increase in losses tapers off.

Mr. GIBBONS. Well, we have to rely upon you to spend a lot of time on this—where we are very generalist up here and cannot spend much time on it—and looks to you for leadership.

Do you have a bill you are pushing?

Mr. THARP. H.R. 3930.

Mr. GIBBONS. Where is that bill right now?

Mr. THARP. It is in the Education and Labor Committee of the House.

Mr. GIBBONS. Are they about to report it?

Mr. THARP. Well, I understand it is presently under review in the full committee, and I am sure that the members of the committee have a keener idea than I do as to precisely where it stands.

Mr. GIBBONS. Well, Mr. Erlenborn and Mr. Dent used to follow this thing very closely, but Mr. Dent is gone and Mr. Erlenborn is going.

Who over there is really following it in that committee?

Mr. THARP. Mr. Clay and Mr. Erlenborn are the two key members in this regard.

Mr. GIBBONS. Well, how about in the Senate? What is happening over there?

Mr. THARP. In the Senate, there is S. 1227, which is before Senator Nickles' Labor Subcommittee of the full Labor and Human Resources Committee. It has recently been pulled out of that subcommittee and is before the full committee under the chairmanship of Senator Hatch for consideration.

Mr. GIBBONS. Now, are those bills in such a position in those two committees that the PBGC or the administration could support them?

Mr. THARP. As I was indicating earlier when I used the figure 95 percent, I would say we are 95 percent of the way. The administration and PBGC are in full support of the overall package. There are still some minor technical adjustments that need to be made, sir. But we feel that we have reached a package which makes sense and which takes into account the interests of the various parties concerned.

Mr. GIBBONS. Well, I will tell you, from my own 32 years of legislative experience, if you have got 95 percent of what you want, you've got a hell of a lot more than most of us usually get. You better grab it and run.

[Laughter.]

Mr. THARP. I would be happy to, sir.

Mr. GIBBONS. All right. Well, you think that will begin to calm down the increase in demand for an increased premium, if we pass this bill?

Mr. THARP. I believe so.

Mr. GIBBONS. Either 3930 or 1227?

Mr. THARP. Yes. And our projections, as you see, are to carry the program over a 15-year period.

Mr. GIBBONS. OK. You still do not know when they plan to move them or anything?

Mr. THARP. I am afraid that that is a question which I would hesitate to answer from my position on this side of the table. But from the administration's perspective, we would like them to move as soon as possible.

Mr. GIBBONS. Well, you can send them a little message from me. Tell them I do not plan to vote for any tax increase until we can see the color of the package they have over there.

You know, I do not have much power, but one of the powers I have is just not doing anything, and I do not plan to do anything until they get that reform in shape so that you can support it. So if you will just take them that message very clearly, we could perhaps shorten this debate.

Mr. THARP. Very good.

Mr. GIBBONS. I have a lot of questions I want to ask you. But as I say, my basic feeling is that maybe we have a bad idea here that we do not know how to handle. And maybe right now the best I can do is not do anything until I see in firm form what you plan to do and then decide whether or not I would want to levy a tax on successful people.

I have a feeling that the sharpies in our society are playing this game, both ends against the middle, and I am just very skeptical about the whole thing. If you would take that message back, I think that is the best I can do for you right now.

Mr. THARP. We believe that the package we have put forward and the proposals that we made here before you today are the essentials of what needs to be done to do the job, and we hope that that will form the basis for what will come before the committee.

Mr. GIBBONS. Thank you.

Chairman RANGEL. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

If the abuse potential, loopholes, or weaknesses had never existed in the single employer program, would you still be here? Would there still be a deficit today?

Mr. THARP. I believe that there would. We are going to be submitting detailed figures at the request of the chairman in order to set forth what may be attributable to the abuse situations and what may be attributable to the normal course of business.

Chairman RANGEL. If the gentleman would yield.

Mr. DUNCAN. Certainly.

Chairman RANGEL. I thank the gentleman from Tennessee.

In response to my question, I thought you unequivocally indicated that it was the recession that caused the historic number of terminations, which increased your deficits. And the figure that you gave me was that the percentage of abuse, while difficult to determine with any degree of accuracy, was less than a quarter of your losses.

Mr. THARP. No, I do not think I indicated that.

Chairman RANGEL. I thought you said you lost \$430 million and that \$105 million was attributed one way or the other to—

Mr. THARP. The deficit was increased by unusually large losses in 1982, which were expected to total \$80 million, but which were in fact \$220 million. That is not the full amount of the over \$450 million deficit.

Chairman RANGEL. Well, in answer to Mr. Duncan, what you are saying is that you are not certain, if we had eliminated the abuse in the original legislation, whether or not you would be before the Congress today asking for an increase in premiums? Is that your testimony?

Mr. THARP. No. I think I could give you a ballpark figure as to the amount that is attributable to the other situation.

Chairman RANGEL. I would ask that Mr. Duncan ask his question again, because I think I was mistaken on your answer.

Mr. DUNCAN. My question was, if the abuse potentials, the loopholes or weaknesses had never existed in the single employer program, would you still be here? Would there still be a deficit today?

Mr. THARP. I believe that there would be, and I would say that since \$105 million of our total losses relates to these abuses, had we

not had those abuses, our deficit would be lowered by roughly that amount. This, unfortunately, the necessary premium would still be higher than the \$2.60 that is presently in place.

Mr. DUNCAN. But it would be less than the \$7 you are requesting, is that correct?

Mr. THARP. It would be less than the \$7 we are speaking about. However, having incurred those losses already, \$7 is now the minimum necessary to retire the accumulated deficit.

Mr. DUNCAN. And you think it is necessary to link a premium increase to the reform legislation?

Mr. THARP. Yes, because if we do not have that what will happen is that there will be additional losses through those loopholes in future years, so that we would be talking about an \$8 or \$9 or higher premium as those additional losses accrue.

Mr. DUNCAN. What businesses today have the greatest economic incentive to terminate their defined benefit plans?

Mr. THARP. I hesitate to name industry groups, because it does not arise in that way.

Mr. DUNCAN. Is it large or small?

Mr. THARP. No, it relates to what the relationship is between the net worth of the company at the given point in time and its unfunded pension liability. If the unfunded pension liability is more than 30 percent of net worth at the moment when the company is looking at it, then there is an incentive for the company to game the system by terminating its pension plan and turning over their underfunding to the PBGC.

Mr. DUNCAN. I find a lot of small business people are really struggling with underfunded plans, and I do not hear too much from the large businesses. Is that pretty much the pattern? Is that who we are after—the small businessman?

Mr. THARP. No, I do not believe that the problem can be divided among small business or big business in this regard. I believe the problem is after the companies that would abuse the system by hiving off liabilities in instances where they can in effect game us.

Mr. DUNCAN. Did I understand you to say that you have devised a plan, over a 10-year period, to bring the fund up to what it is supposed to be?

Mr. THARP. Yes. The amortization schedule for net experience losses is 15 years in those instances.

Mr. DUNCAN. For underfunded plans?

Mr. THARP. That is correct. They amortize their experienced losses over that period.

Mr. DUNCAN. What must they do to come under that plan?

Mr. THARP. Excuse me?

Mr. DUNCAN. What must they do to come under that plan?

Mr. THARP. It is the normal rule, so they are able to do that in every instance.

Mr. DUNCAN. Thank you very much.

And thank you, Mr. Chairman.

Mr. THARP. You are welcome, sir.

Chairman RANGEL. Thank you.

Let me understand that. The \$7 projection is just looking at the normal economic cycles, but there is no insurance protection

against a level higher than this if we have a bad year like 1982, is that correct?

Mr. THARP. If you had a worse year than 1982 more frequently than every 8 years, there is no provision in this projection for that. To look at it in another way, if you had a single extremely large loss, a company whose plan underfunding was more on the order of \$75 million, \$100 million, \$500 million or more that is not accounted for in this projection.

Chairman RANGEL. So if we did, then you would have to come back for another increase, is that correct?

Mr. THARP. That is correct, Mr. Chairman.

Chairman RANGEL. And in terms of your projections for terminations in the future, is that based on a study of your past experience?

Mr. THARP. That is correct. It is based on extrapolation of our claims history, as it would be in any insurance company that was trying to relate a premium to actual claims experience.

Chairman RANGEL. And your testimony would indicate what your projections are in terms of having to pay out during the next—

Mr. THARP. Five, ten, and fifteen years.

Chairman RANGEL. Why is it 15 years now, instead of the 5 years?

Mr. THARP. Well, you know, in any projections the further you get away from the present, the more assumptions and the further from probability you get. Obviously, a 5-year projection can be better than a 10-year or a 15-year projection.

Fifteen years seemed a reasonable timeframe because that is the timeframe that is used for amortization of unfunded pension liabilities. That is about as long a period as we felt reasonably we could go.

Chairman RANGEL. Is there anything that is in your testimony or in the premium-risk relationship study that you will be submitting to indicate what the impact will be on small businesses that try to reach the criteria that we establish? Has there been any projection as to what economic impact the \$7 would have as opposed to the current rate?

Mr. THARP. Well, we have attempted to be sensitive to the particular concerns of small business in this area. Part of their reaction, of course, relates to the amounts that they would pay. If you are talking about employers with fewer than 100 employees, then you are talking about less than \$700 a year, and obviously that is a much smaller number than if you are talking about an employer with 100,000 employees.

Also, in certain provisions of the legislation as it is set forward, there are de minimis rules which answer some of the concerns of small business. Certain transfers below a certain size would not be caught by the 10-year rule, et cetera, et cetera.

Chairman RANGEL. But you do not expect that the \$7 yearly premium would have a negative impact on the future of private pension plans?

Mr. THARP. No. On the contrary, I think that to the extent we can guarantee the security of defined benefit plans by putting this

program on a sound basis, it should encourage the formation of defined benefit plans.

[The following was subsequently received:]

PENSION BENEFIT GUARANTY CORPORATION,
OFFICE OF THE EXECUTIVE DIRECTOR,
Washington, D.C., May 3, 1984.

HON. CHARLES B. RANGEL,
*Chairman, Subcommittee on Oversight of the Committee on Ways and Means,
Washington, D.C.*

DEAR MR. CHAIRMAN: During my testimony before your Subcommittee on March 20, 1984 on the single-employer insurance premium and related legislative reform proposals, you expressed interest in data from the risk-related premium study conducted by the PBGC. This is to inform you of the status of that study.

In January of this year, a draft of the feasibility of a risk-related premium structure was completed and circulated to the PBGC Board of Directors for comment and approval. We recently received final comments on the draft from all PBGC Board members and interested Administration personnel. As a result of these comments, some modification to and expansion of the existing draft may be necessary.

As soon as the revisions to this have been incorporated, it will be circulated once more to the PBGC's Board of Directors for approval. Upon Approval, the study will be conveyed by the Secretary of Labor to your Committee and to the other appropriate Congressional Committees.

Yours sincerely,

C. C. THARP,
Executive Director.

Chairman RANGEL. Mr. Gibbons.

Mr. GIBBONS. As I said before, I am not sure the whole idea is a very good idea at all. Maybe we should have just not ever taken this trip.

Well, let me ask you, why do we not use bankruptcy as a test for the time in which you could cast off a plan? Would that not be a greater discipline?

Mr. THARP. Well, there have been various proposals as to the exact test. As our current proposal indicates, we are moving toward a concept which relates termination to the financial distress of the plan's sponsor.

Mr. GIBBONS. Because now management can say, well, we got rid of the plan and we will go merrily along our way. But if you use bankruptcy as the test, they are going to hang onto the plan until they have to go merrily along a new route, and I think there is a greater amount of incentive to not throw these plans away, but to try to correct them.

If both of them say, well, this plan is bad, it is pulling us toward bankruptcy, but we cannot get rid of it until we get to bankruptcy, I think both sides of the picture would look at it a little bit more closely, rather than being able to throw it away when the unfunded liability exceeds 30 percent of the company's net assets.

Mr. THARP. We are on precisely the same wavelength here.

Mr. GIBBONS. Is the administration promoting bankruptcy as the test or is it still sticking to the 30 percent rule?

Mr. THARP. No, the test under the so-called distress termination will be the financial hardship of the employer. And in looking at statistics in recent years, we have seen that 80 percent of the insufficient plans that come to us 80 percent of them, are in reorganiza-

tion or in liquidation proceedings; 20 percent of them are ongoing companies.

So to the extent that we tie this concept of termination to employer distress, we will be getting to precisely the concern you are enunciating.

Mr. GIBBONS. Well, you told me a while ago that you are 90 percent satisfied or 95 percent satisfied or you had ironed out 95 percent of your differences on this H.R. 3930 and S. 1227. Now, is that the final draft? Are these new drafts?

This whole thing looks so iffy to me. We are here having a hearing as to whether there should be a tax increase, and I just want to make it very clear I am not for any tax increase until we are thoroughly satisfied that the reforms are in place. I would frankly rather let them pass the reform of the plans and have the President sign it before I look at a tax increase than to put up the money and let the thing get sort of watered down as it goes through the legislative process.

How close are you to really getting a hard reform in this area?

Mr. THARP. Well, I think that we are at the point where we have that package and it is in a position where it can move forward. I would not hold up one for the other or the other for the one. It seems to me that the two are interrelated, and to the extent that we can move both forward together I think that is the thing to do.

Mr. GIBBONS. I hate to disagree with you. What happens when we put up the money? I have found in the highway trust fund, the airport trust fund, and all these other trust funds, oh gosh, everybody gets happy and all the reforms that have been talked about usually never come about after we put up the money.

And so what I want to do is see the reforms in place and then put up the money.

Mr. THARP. Well, sir, it is in the nature of things that it would have to be in the same bill.

Mr. GIBBONS. No, it does not have to be. You all may think it has to be, but it does not have to be. You can put it in place and we can put up the money. And frankly, I have found that in conference—there are a lot of differences between this House bill and the Senate bill, are there not? A lot of differences. You are supporting both of them?

Mr. THARP. I believe that the different parties are speaking to one another and reaching common understandings as to what has to be in both bills after markup.

Mr. GIBBONS. Well, just as legislative strategy, so you will not think I am upsetting anything, I want to tell you that if I am a conferee I want to see the reforms in place before I put any money on the line.

Mr. THARP. I would agree with you. I think we have to have both.

Mr. GIBBONS. This is a substantial increase, from \$2.60 to \$7. Frankly, I am not asking you to project how long it will last, because I have no faith in anybody's projections around here any more. I have lived long enough to see them all turn sour.

So let us get those reforms in place and fast, or there is not going to be any money forthcoming as far as this member is concerned.

Chairman RANGEL. Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

I have some basic questions to ask. I came in late, so if these questions have been asked by other members please let me know and I will get a briefing from the staff or check the record itself.

Did you state for the record what the Corporation's cash flow projections are?

Mr. THARP. Yes, I indicated that as early as in this fiscal year we will for the first time see a negative cash flow situation at the Corporation.

Mr. ANTHONY. Specifically, did you state what the amount of the income coming in will be and how much you expect to pay out?

Mr. THARP. The figure in gross results in a negative cash flow of over \$400,000 in this fiscal year, according to the accounts that we have submitted with the President's budget.

Mr. ANTHONY. But have you put those numbers in the record, the income and the outlays?

Mr. THARP. I will see that they are entered in the record.

Mr. ANTHONY. Could you do that, so that we will know the magnitude of what you are talking about?

Mr. THARP. Yes.

[The information follows:]

President's fiscal year 1985 budget, Pension Benefit Guaranty Corporation

Outflow:	Thousands
Administration.....	\$32,898
Benefit Payments	182,000
Financial Assistance	1,500
Capital Investment	159
Outflow = Total Obligations.....	216,557
Inflow:	
Interest on Government Securities	25,453
Premium Income	101,043
Other Income.....	1,100
Benefit Payment Reimbursement	88,070
Net Change in Obligated Balance	478
Total	216,144
Net Cash Flow (Negative).....	413

Mr. ANTHONY. And also, would you put in the record your expectations as to when you expect that that income is coming and when the outflows are due, so that we can determine where this \$400,000 exists; that is, if it is just at the end of the year or if it is higher or lower some time during the course of the year?

Mr. THARP. Yes.

[The information follows:]

As the response to your previous question indicates, the receipts from premiums is PBGC's largest single inflow. Approximately 70 percent of PBGC's premium receipts (\$101 million) is received in late July and early August. PBGC's cash flow for its other accounts (both inflow and outflow) is expected to be reasonably uniform throughout the year. Therefore, except for July and August, PBGC expects its monthly cash flow to be negative. The \$413,000 negative cash flow reflected in the President's budget for Fiscal 1985 represents the first time the PBGC expects its combined program (multiemployer and single-employer) cash flow to be negative on an annual basis.

Mr. ANTHONY. Based on what Mr. Gibbons said, I guess there are a lot of members that are a little sour with projections. We have

all sorts of projections and we are trying to make some pretty serious policy decisions based on them.

How close have your projections on future claims and premium needs been to actual experience? What is your track record?

Mr. THARP. There have been good projections and there have been projections that events overtook, as we say. The year when our projections were most askew was a year of extraordinarily high claims, 1982, when nobody's projections came in anything close to the \$220 million in losses that we experienced.

We would have expected something on the order of \$80 million in that year in terms of the projection we had given some time before that.

If the premium increase is not enacted, our deficit would widen exponentially in future years.

Mr. ANTHONY. I would like for you to provide detailed numbers, comparing your projections to your actual experiences, so that we will have the opportunity to gauge the accuracy of these projections.

We have run into this problem in social security, and with a lot of other Government programs. I think it would be helpful to us to look at what you say your projections were and then compare that with actual experience. If the projection is out of kilter high or low, you could attempt to explain the discrepancy.

Obviously 1982 was a terrible recessionary year and I assume that that contributed to the problem.

Mr. THARP. We would be happy to do that, and in fact we have a white paper which details how components of the different projections add up to the need for a \$7 premium and what those components are. I'd be happy to submit that for the record.

Mr. ANTHONY. That would be helpful.

[The information follows:]

SUMMARY OF BASIS FOR A \$7 PREMIUM FOR THE SINGLE-EMPLOYER BASIC BENEFITS INSURANCE PROGRAM

The Pension Benefit Guaranty Corporation, on behalf of the Administration, is seeking Congressional approval of an increase in the single-employer premium to \$7.00 per participant effective for plan years commencing on and after January 1, 1984. The current premium of \$2.60 has been in effect since January 1, 1978.

In May 1982, the PBGC began seeking an increase in the premium to \$6.00, effective January 1, 1983.¹ However, because this premium increase has not occurred and circumstances have changed since May 1982, the \$6.00 rate is no longer adequate if the PBGC is to retire its current deficit and cover expected new claims and administrative costs. A \$7.00 premium, effective January 1, 1984, is the lowest rate that will enable the Corporation to operate on a financially prudent basis. This paper provides a brief summary of the basis for the \$7.00 premium rate.

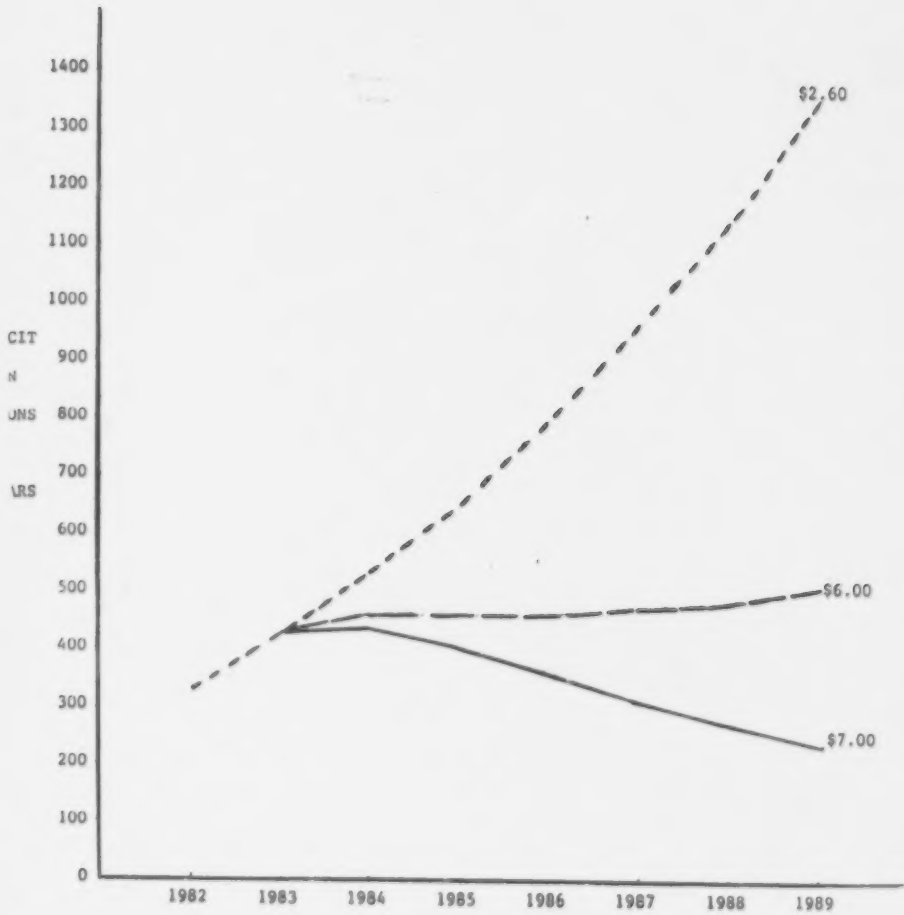
When the May 1982 premium study was conducted, the deficit as of September 30, 1981 was \$188.8 million. During the later part of Fiscal 1982, however, the PBGC experienced much larger claims than it had expected, causing the deficit as of September 30, 1982 to rise to \$333 million compared to the \$236 million predicted for the end of calendar year 1982. (See Attachment 1.) Also, Congressional approval of the \$6.00 premium did not occur; thus during 1983, \$3.40 in additional premium per participant was not received and the PBGC had to forego approximately \$100 million in revenue. These two factors have caused preliminary estimates of the single-

¹ The basis for a \$6.00 request is explained in detail in the study entitled, "Premium Requirements for the Single-Employer Basic Benefits Insurance Program, May 1982". It should be referred to for an in-depth discussion of the original basis for PBGC's \$6.00 premium request.

employer deficit to rise to over \$430 million as of September 30, 1983 and to over \$450 million on January 1, 1984.

The continued growth in the deficit, in the absence of a premium increase, is a major factor causing the PEGC to have to increase its requested premium from \$6.00 to \$7.00. As illustrated in the chart on the following page, in the absence of a premium increase, the projected deficit will increase to about \$550 million by September 30, 1984, \$1,150 million by September 30, 1988, and \$2,500 million by September 30, 1993. Raising the premium to \$7.00 as of January 1, 1984 will cause the deficit to decline gradually.

IMPACT OF PREMIUM INCREASE ON DEFICIT



The following table shows the approximate amounts needed to finance the major components of PBGC's May 1982 and current premium requests. (See also Attachment 2.)

	May 1982 request	Current request
Finance expected future claims.....	\$3	\$4.50
Retirement of deficit.....	2	1.50
Administrative expenses.....	1	1.00
Total.....	6	7.00
Time required to amortize deficit (years).....	5	Over 10
Effective date of premium increase.....	1-1-83	1-1-84

The increase in the amount needed to finance expected future claims reflects the impact of: (1) an increase of about 25 percent to cover Fiscal 1982 claims experience and (2) the averaging of claims over a later and longer period of time.

In order to hold its premium at the lowest possible rate, PBGC is taking as long as it reasonably can to retire the deficit. If the PBGC uses a 5-year deficit retirement period, as in the May 1982 study, a premium of about \$8.50 would be required.

The \$7.00 premium also makes no provisions for establishing a reserve or surplus for extraordinarily large claims occurring. It is based on an extrapolation of PBGC's historical experience which contains no claim larger than \$63 million.

The \$7.00 request also assumes the number of participants in plans covered by the PBGC will continue to grow, based on its historical growth rate of 1.1 million per year.

The timing of the premium increase is also urgent. The PBGC expects that its cash flow will turn negative for the first time in 1984. Expected receipts from PBGC's premium at the \$2.60 rate and the expected investment income on PBGC's assets will no longer exceed the expected disbursements for benefit payments and administrative costs. While the PBGC has \$1.05 billion in assets, these assets together with investment earnings thereon, must be able to pay \$3.9 billion in future benefits.

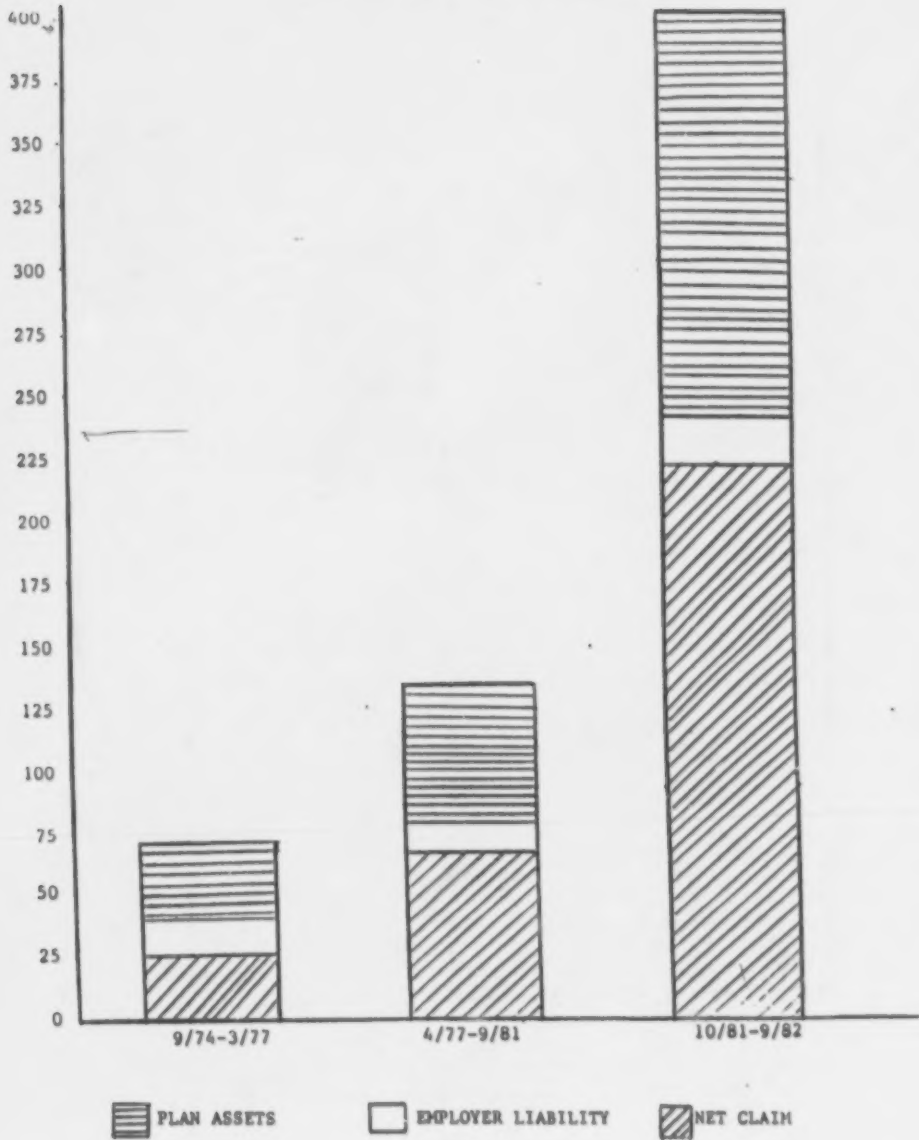
An effective date of January 1, 1984 is also critical because over 70 percent of PBGC's participants are in plans which are on a calendar basis. Delaying the effective date beyond January 1 would cause the vast majority of a premium increase to, in effect, be deferred another year. If the premium increase is delayed until January 1, 1985, PBGC's current request of \$7.00 would have to be increased to over \$7.50.

The Corporation's requested increase in the premium rate is based on the premise that PBGC's claims should be "currently funded" when they occur. This program should not be funded on a "pay as you go basis". This means that the Corporation shall attempt to have on hand at any point in time, assets which, together with the return that can be achieved on their investment, will be sufficient to pay all liabilities assumed by it at that same point in time. This is the same philosophy that all private sector insurance companies must follow. In fact, such companies also establish a reserve for unforeseen contingencies—including larger than expected claims.

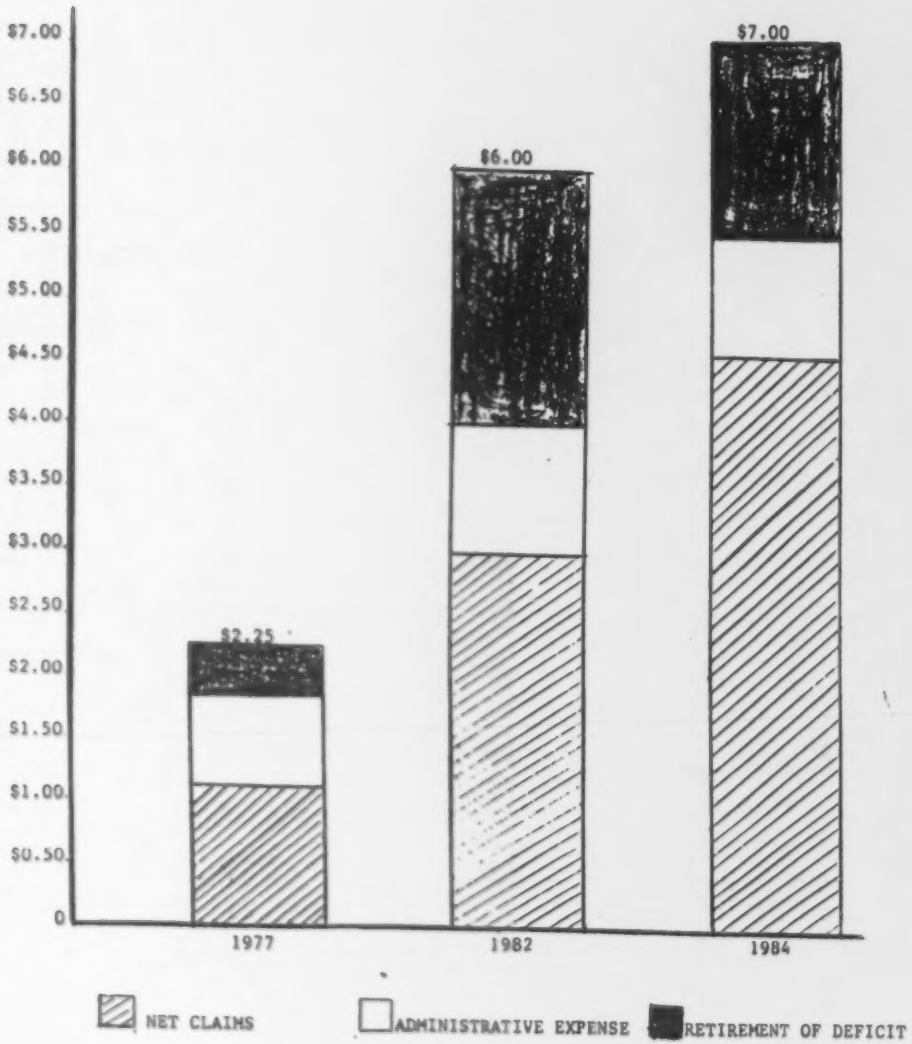
The longer a premium increase is delayed, the greater the ultimate increase would have to be. This, in turn, increases the likelihood that the Corporation would ultimately have to exercise its borrowing authority from the U.S. Treasury and/or have its liabilities financed from general tax revenues rather than premium income.

The PBGC believes that the \$7.00 premium it is requesting is a very modest amount. It represents much less than 1% of average annual pension cost, and will, together with the loophole-closings proposed in the pending legislation on the Hill, place PBGC on a firm financial footing for the foreseeable future.

ATTACHMENT 1
AVERAGE ANNUAL CLAIMS
(in millions of dollars)



ATTACHMENT 2
COMPARISON OF COST COMPONENTS OF THE PBGC
PREMIUM REQUESTS, 1977, 1982 and 1984



Mr. ANTHONY. Is there any way to increase certainty or reliability in your projections?

Mr. THARP. Well, I suppose you could always refine a little further. I think that in any insurance program which is only a few years old—and we have only had 8 years experience under the belt—as you go further down the road you have more actual experience on which to base your projections and on which to say what the claims will be in the insurance program. Then with each passing year we will have a much firmer basis for making our projections.

Mr. ANTHONY. Again, if you have any suggestions you can make to the committee, other than just having more history by which to gage, on how you could increase the certainty and the reliability of the projections, that would also be beneficial to us. If you have anything in-house, such as a white paper, I think it would be helpful.

[The information follows:]

In order to project net claims, the PBGC has considered a number of forecasting techniques. The 1977 premium study was based on an observed correlation between the unemployment rate and historical claims experience from September 1974 through March 1977. In 1982, we tested a variety of forecasting methodologies including the use of economic indicators and regression analysis techniques. However, none of the methodologies tested proved to be more valid than our present method of utilizing past experience to project future claims.

The nature of projections, however, is in itself uncertain. There are a number of factors which can have a significant effect on the level of actual claims experienced. These include: (1) the number of insufficient terminations per year, (2) the number of participants in terminated insufficient plans, (3) the value of guaranteed benefits per participant, and (4) the percentage of plan assets and employer liability obtained from the plan or the plan sponsor.

Large, unexpected claims have a substantial impact on PBGC's claims experience. While PBGC's claims from small plan terminations has proven relatively stable, the effect of large plan terminations has produced volatile swings in year-to-year experience.

PBGC continues to monitor the financial condition of employer with plans that could result in significant claims against the PBGC and to test various forecasting methodologies in an effort to improve claims predictions.

Mr. ANTHONY. I have one last question. How well funded are defined benefit plans today?

Mr. THARP. Well, I must say that, because of the recent rise in the stock market and because of the continuing high interest rates at which pension benefits are discounted, the aggregate figures on the funding of defined benefit plans are much better now than they were a year or two ago.

That gives us good reason to hope that we will be returning to a level of normalcy in our claims experience, that we will have the \$140 million a year average loss over the next 5 years instead of having worse.

Mr. ANTHONY. All right. You are saying that the defined benefit plans, because of certain market conditions, are in better shape than they have been in the past. But you anticipate that, just because of that, the claims will only fall back down to some normal range, rather than falling below a normal range.

I was hoping that the answer would be that it would fall below some normal range, and then that might give me some arguments to take a look at that \$7 premium request.

Mr. THARP. Well, I do not yet see any indication that that will occur, certainly not in terms of what is presently coming in the

door. It has been our experience over time from the beginning of the program that 97.5 percent of plans that come in our door are sufficient. We only look at that level figure.

But if they are 100 percent funded, that is all that concerns us. If there is a further amount, 125 percent, 150 percent, 180 percent, well, that is fine, but for other purposes, not for the purpose of defining a deficiency.

Mr. ANTHONY. Mr. Chairman, I do have one further question.

I do not know the magnitude of the participation from my home State of Arkansas. Do you have that information.

Mr. THARP. Well, I do not know that we have a State-by-State breakdown, but I will ask when I get back to the Corporation my people to provide something. I do not know.

Mr. ANTHONY. Any information that you have on your program as to how it applies to people in my State I think would be informative for me.

I yield back to the Chair.

Chairman RANGEL. Mr. Tharp, I do not know as much about this fiscal crisis as I should, but it is my understanding that the President's so-called 1985 budget reflects that we have already passed this premium rate increase to \$7. Is that correct?

Mr. THARP. Well, the President's budget always includes the various proposals that are being made to the Hill, and the President's budget does reflect the \$7 request. We also can provide you with numbers, and I believe that they are public, as to what \$2.60 means.

Chairman RANGEL. OK. Let me tell you, my problem is that it is rumored, at least reported in the press, that the President has changed his attitudes as they relate to taxes and dealing with the deficit. I do not know whether that is a fact, but if indeed this premium increase has been included in his budget, I am just going to assume that we can get some type of statement early on from the President and from the administration to indicate that the Congress is not moving toward a tax, tax, tax, spend, spend, spend philosophy, and that indeed this is the President's analysis of a serious fiscal problem that could best be met by an increase in premium.

Mr. THARP. I can assure you that the \$7 is an administration proposal and that the White House is behind it at this moment, as it was at the time the budget was submitted.

Chairman RANGEL. Well, I hope that for purposes of the calendar year that we are working in that the President can come from behind it and attempt to be in front of it as we attempt to support your request.

Mr. Duncan, do you have other questions?

Mr. DUNCAN. I have no other questions.

Chairman RANGEL. Are there any other questions, Mr. Gibbons?

Mr. GIBBONS. No, thank you, sir.

Chairman RANGEL. We have a lot of work to do and so does your agency. I do hope that you continue the dialog between the interested parties, that you submit the risk-related premium information, so that we would have some way to explain to our constituents what you have eloquently explained to this subcommittee as to why this increase in premium is necessary.

I am very serious that it would be helpful if the administration managed to get out some type of statement that did not increase panic with our employers and employees, but at least so that members of this committee would know that the administration believes that this is the responsible thing to do and that we would not be subjected to any political attacks for doing the right thing.

Mr. THARP. I can give you that assurance presently, and I can provide whatever additional documentary assurance you need, Mr. Chairman.

Chairman RANGEL. I do not have any problems with your position on this, Mr. Tharp. But I think the members would feel a lot more secure if we had some other people associated with your position.

Mr. THARP. Very good.

Chairman RANGEL. Thank you.

Mr. THARP. Thank you for the opportunity.

[The following was subsequently received for the record:]



Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

March 20, 1984

The Honorable Charles B. Rangel
2330 Rayburn House Office Building
Washington, D.C. 20575

Dear Mr. Chairman:

This is in response to your questions at last week's hearing as to whether the legislative reforms to the single-employer-plan pension insurance program are supported by the President and the Administration.

Attached for your attention is a copy of the letter from Secretary Donovan to Representative Rostenkowski supporting the \$7.00 premium increase and the attendant single-employer plan reforms. As you will note the concluding paragraph, which had been approved by OMB, states that this proposal "is in accord with the President's program".

I trust that this answers the question you raised at our March 20th hearing.

I remain,

Yours sincerely,

A handwritten signature in cursive script that reads "C. C. Tharp".

C. C. Tharp
Executive Director

CCT/gg



Pension Benefit Guaranty Corporation
2020 K Street, N.W. Washington, D.C. 20006

MAR 16 1984

Honorable Dan Rostenkowski
Chairman, House Committee on
Ways and Means
United States House of Representatives
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the Board of Directors of the Pension Benefit Guaranty Corporation (PBGC), I am writing to request that the premium charged to plan sponsors of pension plans covered by PBGC's single-employer insurance program be raised from the current \$2.60 per participant per year to \$7.00, effective January 1, 1984. As proposed in the President's Budget for FY 85, a \$7.00 premium is now necessary in order to amortize the growing single-employer deficit over a reasonable period of time.

In testimony before Congress last year, PBGC expressed the Administration's support for an increase in the premium to \$6.00 effective January 1, 1983, as contained in S. 1227 and H.R. 3930. PBGC indicated at those hearings that based on PBGC projections of anticipated losses an increase in the premium to \$6.00 was necessary in order to begin to amortize the then-existing deficit of \$333 million in the single-employer program. Congress has yet to take final action on a bill to raise the single-employer premium and amend Title IV of ERISA. H.R. 3930 has been marked up by the Labor and Management Subcommittee of the House Education and Labor Committee, and S. 1227, pending in the Labor Subcommittee of the Senate Labor and Human Resources Committee, is scheduled for markup this month.

Our current request for a \$7.00 premium reflects the need to make up for the nearly \$100 million in revenue lost during 1983 largely as a result of a \$6.00 premium not being enacted by Congress effective January 1, 1983. As a result of this revenue loss and several unanticipated large terminations, our estimate of the single-employer deficit has now risen to over \$430 million.

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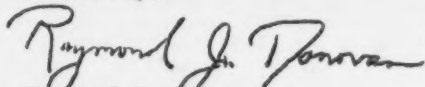
PBGC now finds itself in a position where \$7.00 effective January 1, 1984, is the minimum premium required if PBGC's program is to remain properly financed as an insurance program and is not to become a "pay-as-you-go" program. A \$6.00 premium is now inadequate to retire the deficit over any length of time, principally because as of now projected expenses and interest on the deficit would outstrip income produced by the \$6.00 receipts. Even at a \$7.00 premium, we expect it will take 15 years to retire the deficit. Such an amount assumes that our previous estimate of growth of numbers of participants in defined benefit plans by 1.1 million per year will be borne out in practice, when in fact that may be an optimistic assumption. It also contains no premium for the occurrence of extraordinarily large claims, in excess of the annual average of \$140 million that we have forecast for the next six years. Therefore, we regard the \$7.00 request as a conservative figure.

The immediate need for the increase is now even more apparent than it was in the last session of Congress. Sometime in this fiscal year or early in FY 85, PBGC's cash flow, as reflected in the Federal Budget accounts, will turn negative, based upon the normal course of business presently projected, and PBGC will for the first time be adding to the size of the Federal deficit rather than reducing it. Such a trend would accelerate alarmingly in succeeding years should an increase not be adopted.

As you are aware, the Administration supports legislation to strengthen the single-employer insurance program, and I would like to take this opportunity, on behalf of the Board of Directors, to thank you for the significant contributions you have made in this area of pension policy. Any efforts to insure enactment of this critical premium increase and related legislation will be invaluable both to the American business community and to the American worker.

The Office of Management and Budget advises that there is no objection to the submission of this report and that enactment of the premium increase to \$7.00 would be in accord with the program of the President.

Sincerely,



Raymond J. Donovan
Chairman



Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

DEC 9 1983

MEMORANDUM FOR THE HONORABLE RAYMOND J. DONOVAN
CHAIRMAN, PBGC BOARD OF DIRECTORS

Mr. Niakanen called me on December 8, 1983 to ask what PBGC premium should be included in the OMB Budget figures for next year, assuming it were to be effective January 1, 1984.

You may recall that we have previously advised Congress and others that a \$7.00 premium would be needed for 4 years beginning January 1, 1984, instead of \$6.00, to replace the lost \$3.40 increase that was to be effective January 1, 1983. The premium could then drop to \$6.00 in the 5th year, assuming actual future experience as to losses, etc. turns out to be as projected.

By contrast, if the lost \$3.40 (\$6.00 - 2.60) is to be made up in 2 years the required premium would be \$7.90. If the lost \$3.40 is to be made up in 1 year, the required premium would be \$7.30.

My view is that OMB use of a \$7.00 figure under all the circumstances is preferable. That figure has been discussed with Congressman Erlenborn and Senator Nickles and various Hill staffers during the final phase of 1983 legislative negotiations. It needs the least explanation, and does not require a caveat that it be effective for only 4 years.

All of the above figures assume retirement of the PBGC deficit over a 15-year period. You will recall that the OMB use of an \$8.00 premium figure a year ago was based on a deficit retirement period of 3 years. That period has not been urged in the 1983 legislative negotiations, and I doubt that it should be revived now.

I advised Mr. Niakanen of the above figures and my thoughts as above, but that I had not been able to clear them with you.

If you conclude that \$7.00 is the proper figure to use for OMB Budget purposes, it would be appreciated if you would leave word at my office that \$7.00 is okay, and I will so advise Mr. Niakanen, unless you prefer to leave word directly with his office.

Edwin M. Jones
Executive Director

cc: Mr. Niakanen



Pension Benefit Guaranty Corporation
2020 K Street, N.W., Washington, D.C. 20006

Honorable Charles B. Rangel
Chairman
Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

JUN 27 1984

Attn: Mr. William A. Kirk

Dear Congressman Rangel:

The Pension Benefit Guaranty Corporation has prepared responses to the questions Mr. William A. Kirk of your staff sent us as a follow-up to the hearings held by the Subcommittee on Oversight on the PBGC's single-employer termination insurance program. The questions and responses, which are based on the latest available data, appear below.

- A. Please supply a spectral (i.e., continuous) analysis of PBGC revenues and liabilities since commencement of the single-employer program.

Results of Operations. PBGC commenced operation September 2, 1974, the date ERISA was enacted. The revenues, expenses and net income/loss for the program are shown below for each year of operation since inception.

Table 1

Revenue, Expenses, and Results of Operations,
Single-Employer Program
FY 1975-1983
(\$ in millions)

	<u>Revenue</u>	<u>Expenses</u>	<u>Results of Operations Income (Loss)</u>
FY75 (10 months)	\$19.4	\$35.1	(\$15.7)
FY76 (15 months)	36.7	62.0	(25.3)
FY77	30.8	85.1	(54.3)

-2-

Table 1 (Continued)

Revenue, Expenses, and Results of Operations,
Single-Employer Program
FY 1975-1983
(\$ in millions)

	(1) <u>Revenue</u>	(2) <u>Expenses</u>	(1)-(2) <u>Results of Operations Income (Loss)</u>
FY78	\$ 57.0	\$ 99.4	(\$42.4)
FY79	87.4	96.0	(8.6)
FY80	93.4	41.6	51.8
FY81	69.6	163.8	(94.2)
FY82	175.8	319.8	(144.4)
FY83	269.8	460.3	(190.5)

As the table shows, the magnitude of PBGC's annual losses in the single-employer program has escalated dramatically since inception.

- B. Include in the above: (1) data showing the percentage of program liabilities covered by plan assets for each year of operation; (2) data showing the percentage of liability that was pre-ERISA and post-ERISA; (3) data showing the percentage of liability attributable to IRS waiver of funding obligations, the percentage of liability arising from terminations involving bankrupt firms, non-bankrupt firms and firms involving a spin-off. (This data will clarify the amount of the premium increase that relates to the absence of program reforms.)

Liabilities Covered by Plan Assets. Table 2 shows the guaranteed plan liabilities assumed by the PBGC in single-employer terminations in each year of operation and the percentage of the liabilities that were funded by plan assets. This percentage has been an average of only 41.7%, reflecting the poorly funded status of insufficient terminating plans.

The table also shows the net claims on the insurance program from the terminations and the percentage of the guaranteed liabilities that become net claims. On average, 50.7 percent of the amount of guaranteed liabilities become net claims because they are not funded by either plan assets or employer liability.

-3-

Table 2

Claims Experience, Single-Employer Program,
FY 1975-1983 1/

<u>Date of Termination</u>	<u>No. Plans</u>	<u>Guaranteed Benefit Liability</u>	<u>Plan Assets</u>	<u>(%)^{2/}</u>	<u>-</u>	<u>Employer Liability</u>	<u>=</u>	<u>Net Claim (%)^{3/}</u>
7/1/74-6/30/75	98	\$ 56.0	\$ 18.9	(33.8%)		\$ 5.0		\$ 32.1 (57.3%)
7/1/75-9/30/76	172	88.4	44.5	(50.3)		26.4		17.6 (19.8)
10/1/76-9/30/77	130	52.2	21.3	(40.8)		7.3		23.5 (45.1)
10/1/77-9/30/78	99	124.6	44.7	(35.9)		6.0		73.8 (59.2)
10/1/78-9/30/79	80	81.7	29.6	(36.2)		4.1		48.1 (58.7)
10/1/79-9/30/80	106	180.1	81.5	(45.3)		5.3		93.4 (51.8)
10/1/80-9/30/81	124	176.1	79.8	(45.3)		25.1		71.1 (40.5)
10/1/81-9/30/82	112	431.2	164.7	(38.2)		6.9		259.6 (60.2)
10/1/82-9/30/83	<u>100</u>	<u>373.4</u>	<u>184.6</u>	<u>(49.4)</u>		<u>14.8</u>		<u>174.1</u> <u>(46.6)</u>
Total	1021	\$1563.8	\$669.6	(41.7%)		\$100.9		\$793.3 (50.7%)

1/ Figures reflect revisions based on the latest data as of 9-30-83.

2/ Percentage of guaranteed benefit liability funded by plan assets.

3/ Percentage of guaranteed benefit liability that is a net claim against the insurance program.

Pre-ERISA and Post-ERISA Liabilities. Table 3 shows the same data as Table 2, except that it groups the data into two categories, pre-enactment and post-enactment. ERISA did not provide for assessment of employer liability on pre-enactment terminations.

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Table 3

Pre-enactment and Post-enactment Claims Experience,
Single-Employer Program,
FY 1975-1983

	<u>Guaranteed Benefit Liability</u>	<u>Plan Assets</u>	<u>Employer Liability</u>	<u>Net Claim</u>	<u>Percent of Net Claims</u>
Pre-enactment	\$ 12.3	\$ 5.2	0	\$ 7.1	0.9%
Past-enactment	<u>1551.5</u>	<u>664.4</u>	<u>100.9</u>	<u>786.2</u>	<u>99.1%</u>
Total	\$1563.8	669.6	\$100.9	\$793.3	100.0%

Impact of Funding Waivers. A recent survey of large cases with funding waivers indicated that PBGC has experienced \$94 million in net claims due to funding waivers in nine cases involving 22 plans. This sample figure is representative of the magnitude of the total net claims that might be attributable to funding waivers. In order to increase the probability of collection, particularly in bankruptcy situations, the Administration has proposed that the plan be given a statutory lien on the sponsor's assets in the amount of the outstanding balance of waived contributions.

Impact of Sponsor Financial Status. The percentage distribution of net claims by status of plan sponsor, from inception through fiscal year 1983 is shown in Table 4.

Table 4

Percentage of Single-Employer Net Claims,
by Status of Plan Sponsor
Fiscal Years 1975-1983

<u>Status of Plan Sponsor</u>	<u>Percentage of Net Claims</u>
Bankrupt or liquidating	18%
In reorganization proceedings	61
Ongoing- not in reorganization proceedings	<u>21</u>
	100%

The proposed single-employer legislation would allow an insured termination ("distress termination") only in the case of business liquidation or extreme business hardship. It would permit terminations in the form of the cessation of benefit accruals ("standard termination") as under current law but would not permit close-out of a plan until all final benefit obligations are fully funded, unless the plan qualifies for a distress termination.

It is difficult to assess the extent of the savings that would result from these provisions. A large percentage of the net claims from ongoing sponsors that are not in reorganization proceedings are related to sponsors that are very weak. However, some weak businesses, including businesses that are restructured under reorganization proceedings, do survive and recover. At minimum, we can be assured that the conditions for granting a distress termination and the proposed changes in the employer liability provisions, which would require ongoing employers of distress-terminated plans to pay the PBGC a percentage of future profits for a limited period of time to finance the cost of unfunded guaranteed liabilities in their plans, would close the door to abusive cases.

Impact of Spinoffs. Based on recently computed total net claims from single-employer plans through Fiscal 1983, about 13 percent of net claims in single-employer cases have involved spinoffs or sales of a division or subsidiary to a weak company and the transfer of unfunded pension liabilities to that company. The contingent liability provisions of the current legislative proposals would assure that the insurance program is substantially protected against losses from distress terminations occurring within 5 years after such a transfer.

- C. Please supply the actuarial assumptions used in the preparation of the estimate for the \$7.00 premium. Contrast these with the estimates prepared for the \$6.00 premium made two years earlier. Specify how they changed and what was the rationale behind each change.

Latest Developments Underscore Need for Premium Increase

Before reviewing the methodology and assumptions for the \$6 and \$7 premium analyses, it is important to bring you up to date on PBGC's net claims and deficit based on the actuarial and financial statements for Fiscal 1983 which we plan to submit to the PBGC's Board of Directors for approval shortly. The latest figures make prompt Congressional approval of the \$7 premium rate more urgent.

Actual experience for Fiscal 1983 was considerably worse than estimated at the time of the \$7 premium study. Net claims for the year totalled \$174 million (compared to the \$105 million estimate) and the deficit reached \$523 million (compared to the \$462 million estimate).

Premium Study Assumptions

The same basic methodology underlies the PBGC's 1982 request for a \$6.00 single-employer premium rate and our 1984 request for a \$7.00 premium rate. The PBGC analyzed the correlation between PBGC net claims and a variety of economic variables but has found that the best predictor of future claims is prior claims history. (See Questions H and I for specifics.) Accordingly, the premium income needs were computed on the basis of projections of past net claims trends. Both analyzes used a 5-year projection of net claims.

The 1982 and 1984 premium needs analyses differ in their assumptions as to the annual growth in net claims, the amount of the deficit to be financed, and the period over which the deficit would be amortized.

Net Claims Projection

The net claims assumption underlying the \$7.00 request assumes average annual net claims of \$136 million for 1984-1988 versus the \$96.8 million per year projected for 1983-1986 under the 1982 \$6.00 study. The reason for this increase was that at the time the \$7 premium analysis was conducted, estimated net claims of \$220 million for fiscal 1982 and \$105 million for 1983, already greatly exceeded the earlier projections of \$96.8 million. The \$136 million average annual claims projection for 1984-1988 assumes that the extremely adverse experience in 1982, which occurred in PBGC's eighth year of operation, will occur, on average, every eight years.

Deficit Amount and Amortization

As a result of the extraordinarily high level of claims in 1982-1983, the deficit projected as of January 1, 1984 under the \$7.00 premium request was \$462 million, compared with the \$236 million deficit projected as of January 1, 1983 under the 1982 study. The \$7.00 request assumes amortization of the \$462 million deficit amount over 15 years. This is the longest amortization period that we consider reasonable. The 1982 study assumed a more conservative 5-year amortization period.

Other Assumptions

Both the \$6.00 and \$7.00 requests assume an annual growth rate of 1.1 million in the number of covered participants on which premiums will be paid. Both requests assume that \$1 of the premium will be required for administrative expenses. Neither request would create a reserve for extraordinarily large claims.

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Table 5 summarizes the assumptions and under corresponding allocation of the premium under both requests.

Table 5

	1982 Request--\$6		1984 Request--\$7	
	Assumption	Premium 1/	Assumption	Premium 1/
Average Annual Net Claims Projected (5 year proj.)	\$96.8 million	\$3.00	\$136 million	\$4.50
Deficit to be Amortized/	\$236 million/		\$462 million/	
Amortization Period	5 years	\$2.00	15 years	\$1.50
Administrative Expenses		\$1.00		\$1.00
Reserve for Extraordinary Losses	-0-	--	-0-	--
		<u>\$6.00</u>		<u>\$7.00</u>

1/ Assumes 1.1 million per year increase in number of covered participants premium base.

- D. Please provide the PBGC estimates of the amount of unfunded liabilities for ongoing plans (i.e., non-trusteed) for the years 1975-1983. Has this increased, decreased or varied as a percent of vested plan obligations? (This should reveal the impact of the ERISA funding standards.)

In conjunction with the Corporation's review of alternative premium structures, estimates were made of liabilities for the covered ongoing plan universe. Data taken from 1979 Form 5500 filings were the most recent available at the time the study was initiated. Total single-employer vested liability was estimated at \$256 billion. The unfunded portion of that liability was \$51 billion or 20 percent. PBGC's claims come from poorly funded plans. For example, for the comparable fiscal years, 1978 and 1979, Table 2 shows that the unfunded portion of guaranteed benefits was in the range of 55-64 percent in insufficient terminations. Data for the ongoing plan universe for 1980-81 is now available. We expect to update our liability estimates for the "universe" using the more recent data later this year.

In our analyses, however, we have found that comparisons of such aggregates--unfunded liabilities compared to total liabilities for the universe--have not been helpful in forecasting our future claims. For example, the trade press has reported various investigations that show total unfunded liabilities have decreased during 1981-83. See also the response to the second part of Question E. But our claims experience during each of those two years was significantly higher than any prior year. Also, the percentage of underfunding the terminations during that period did not show significant improvement. The unfunded portion of guaranteed benefits was in the range of 51-62 percent for terminations in fiscal years 1981-1983.

- E. What impact has recent market appreciation had in PBGC trustee assets? What impact has this appreciation had on the PBGC estimate of nontrusteed plan assets (and unfunded liabilities)?

Impact of Market Appreciation on PBGC Trusteed Plans

In Fiscal 1983, PBGC earned 12.5% on its revolving funds (which are invested in government securities) and 45.9% on its trust funds held by its custodian bank. These returns (plus earnings on other PBGC assets in the process of being collected) produced realized and unrealized investment income for the single-employer program of \$188.3 million. However, despite this good investment performance, the deficit at the end of Fiscal 1983 stood at \$523 million.

Impact of Market Appreciation on Non-Trusteed Plans

As indicated in the answer to Question D, PBGC is in the process of beginning to analyze Form 5500 asset and liability data for the period 1980-1981. The following values are based on available pension information required under FAS-36 to be reported by publicly held firms in their 10K annual reports. The vested liability data is at plan interest rates as of the date of valuation. These values are not comparable to the values given in the answer to Question D based on 1979 Form 5500 information, for the following reasons. The liabilities and the assets of all defined benefit plans of a firm are aggregated for the purpose of this reporting. Therefore, the unfunded liabilities of certain firms' plans would be understated, to the extent that excess assets exist in other plans of that firm. Further, plan valuation interest rates in many large plans increased significantly between 1979 and 1980. The average valuation rate has continued to rise over subsequent years. Also, the assets and liabilities of plans of privately-held sponsors are not included in these values.

As shown in Table 6 below, assets grew from \$255.7 billion in 1980 to \$317.8 billion in 1982. However, the number of firms reporting also grew over that time. Therefore, it appears that

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assets per reporting firm have remained quite stable. The assets for firms with the largest 50 unfunded vested liabilities (UVLs) have not grown--they are at their lowest value of \$40.5 billion in 1982. The particular firms included in the top 50 UVLs will change somewhat from year to year. One reason for this change is that some plans have raised their interest rate assumption sufficiently to result in a significant decrease in their unfunded liabilities.

For all firms with UVLs, vested benefits have decreased over the three-year period. We believe this to be primarily due to the average increase in interest rate assumptions used by plans during this period. The decrease in UVL in 1982 should not be interpreted as an indicant of future decreases in PBGC's net claims. As noted in Question D, we have not found a correspondence between funding levels in the universe of ongoing plans and PBGC net claims.

TABLE 6

PBGC Exposure to Unfunded Vested Liabilities (UVL)
from Ongoing Plans

	Annual Report Year		
	1979	1981 (\$ in billions)	1982
Total firms: <u>1/</u>			
Number of firms	1,900	2,000	2,200
Vested benefits	\$236.2	\$245.6	\$263.3 <u>2/</u>
Assets	\$255.7 est. <u>3/</u>	\$283.7	\$317.8
Firms without UVL:			
Number of firms	1,200	1,400	1,700
Vested benefits	\$156.9 est.	\$152.7	\$194.2
Assets	\$195.7 est.	\$205.8	\$260.4
Excess assets	\$ 38.8	\$ 53.1	\$ 66.2
Firms with UVL:			
Number of firms	700	600	500
Vested benefits	\$79.3 est.	\$82.9	\$69.1
Assets	\$60.0 est.	\$77.9	\$57.4
UVL	\$19.3	\$15.0	\$11.7
Top 50 UVLs:			
Vested benefits	\$55.5	\$63.9	\$50.2
Assets	\$41.4	\$52.2	\$40.5
UVL	\$14.1	\$11.7	\$ 9.7

1/ Based on Standard & Poors Compustat data on firms reporting pension values under FAS-36.

2/ All vested benefits are based on plan valuation rates.

3/ All estimated values are derived based on the average ratio in 1981 and 1982 of assets of firms with UVL to assets of the top 50 UVLs.

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- F. What are the PBGC estimates for vested benefit obligations? Has ERISA vesting rules resulted in a sizable increase since 1974? Since 1980? Are plan vesting practices changing in a way to increase/decrease vested benefit obligation estimates?

As indicated in the response to question D., the Corporation estimated total vested benefit liability of \$256 billion based on 1979 Form 5500 data.

ERISA prescribes minimum vesting standards that all covered plans must comply with. PBGC is unaware of any study that analyzes the effect the minimum vesting standards have had on plan liability. According to the Bankers Trust Company's 1980 Corporate Pension Plan Study there is a trend towards uniform adoption of the 10-year cliff vesting schedule. The change to a service-only schedule is principally at the expense of vesting provisions that vary with both age and service. The study does not identify the cost effect of this trend, if any. The conventional wisdom is that there is almost no cost difference among ERISA's three minimum vesting standards.

- G. How has the defined benefit plan participant population changed since 1974? How is this affecting premium revenue estimates? Insurance liability estimates? In other words, is the number of participants on which premiums are paid increasing or decreasing? As these numbers change, how does it affect PBGC projections for the numbers of participants in plans that may terminate?

Since enactment of ERISA, PBGC's participant count for the single-employer program has continued to grow at a rate of approximately 1.1 million participants per year. For purposes of determining PBGC's future premium requirements, this rate of growth is projected to continue.

PBGC's claims estimate for future years is based on an extrapolation of its past claims experience rather than the number of participants in insufficient terminated plans. To the extent that the increase in claims has been caused by the number of covered participants growing over time, such growth is reflected in our future claims forecast. Because insufficient plans which terminate are generally maintained by businesses in financial trouble, the total number of participants, and even the number of vested participants, may not move in concert with those of the universe of plans. While the number of participants may

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decline or stay constant, the total unfunded liabilities which would be guaranteed on termination may nevertheless increase.

- H. Is there a correlation between the national bankruptcy rate, plan terminations, and PBGC liabilities? What has been the nation's bankruptcy pattern? Is there a sharp increase every 8 years or is there a longer span between jumps in the bankruptcy rate?

National Bankruptcy Pattern

Statistics gathered by Dun & Bradstreet show that business failures 1/ ranged between 6,600 per year and 11,700 per year in the years 1975 through 1980. This represents a failure rate of 28 to 43 per 10,000 firms. The number of failures per 10,000 firms increased dramatically in the next 3 years; 1981-1983. The failures numbered 16,800 in 1981, 25,300 in 1983, representing 61, 89 2/ and 110 2/ failures per 10,000 firms respectively.

The average current liability per failure 3/ has grown rather steadily. In the period 1975 through 1981 it ranged from \$312,800 to \$414,000. Data for 1982 and 1983 are not yet available.

Correlation between National Bankruptcy Rate, Plan Terminations and PBGC Net Claims

Bankruptcy, liquidation or other type of dissolution of a plan sponsor was associated with 78 percent of the net claims 4/ under the single-employer program in fiscal years 1982 and 1983. In earlier years these events were responsible for an estimated 90 percent of net claims.

PBGC's 1982 premium study sought to establish a statistical relationship between the business failure rate or the current liabilities of business failures, and PBGC's single-employer net claims that would enable PBGC to project future net claims. Current liabilities of business failures is a leading indicator of recessions.

- 1/ Certain industries such as financial enterprises, railroads, insurance, real estate companies and many small services are not included.
- 2/ Preliminary data.
- 3/ Current liabilities are measured before subtracting assets do not include long-term debt.
- 4/ Net claims is the amount of unfunded guaranteed liabilities minus employer liability collections and expected collections.

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The study found that there was a very weak, although statistically significant, relationship between the current liabilities of business failures and the number of net claim terminations, although the relationship was not considered adequate for projecting those terminations on a reliable basis. No relationship existed between the amount of net claims and business failure rate or current liabilities. The study found that the best predictor was a trend relationship based on past net claims.

Table 7 shows the number of business failures, failures per 10,000 firms, total current liabilities of failed firms, number of PBGC insufficient terminations and PBGC single-employer net claims for the years 1974 through 1983.

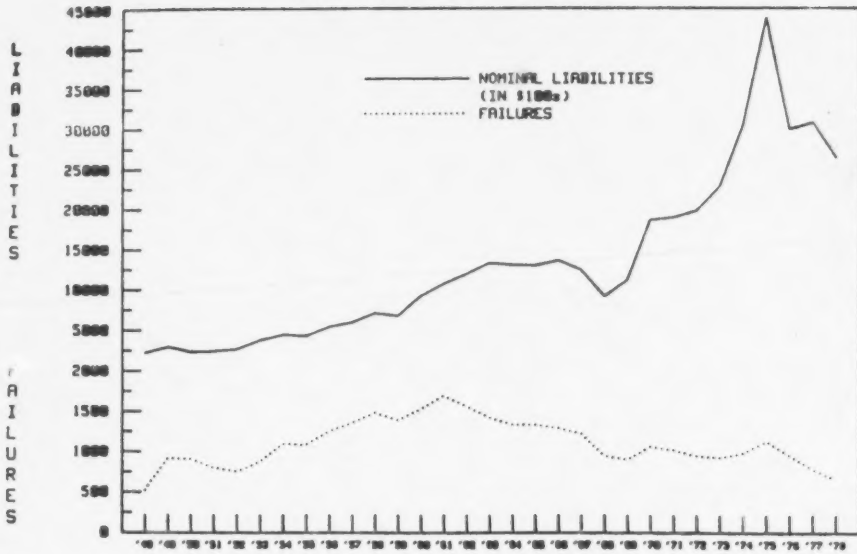
TABLE 7. Business Failures and PBGC Net Claims
1974-1983
(\$ in millions)

	<u>Number of Business Failures</u>	<u>Failures per 10,000 Firms</u>	<u>Failures Liabilities</u>	<u>No. of PBGC Insufficient Terminations^{1/}</u>	<u>Single-Employer Net Claims^{1/}</u>
1974	9,915	38	\$3,048.2	---	---
1975	11,432	43	4,367.2	98	\$ 32.1
1976	9,628	35	3,002.8	172	17.6
1977	7,919	28	3,087.3	130	23.5
1978	6,619	24	2,647.9	99	73.8
1979	7,564	28	2,644.5	80	48.1
1980	11,742	42	4,617.9	106	93.4
1981	16,794	61	6,915.4	124	71.1
1982	25,346	89p	N/A	112	259.6
1983	31,334	110p	N/A	100p	174.1p

^{1/} Fiscal year basis.

p = preliminary

GRAPH 1

NUMBER OF BUSINESS FAILURES
AND TOTAL LIABILITIESSource: Dun & Bradstreet, The Business Failure Record For 1979

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Graph 1 shows business failure rates and current liabilities of failed firms over time. The total number of failures and the failure rate were quite low in 1948, rose substantially through 1961, and fell during the period 1962-1978. The current liabilities of failed firms have grown disproportionately to the increases in failure rates, particularly since the 1960's. There is no clear pattern of peaks, although failure rates tend to rise somewhat during recessionary periods.

- I. Why did the PBGC assume that liability claims of the magnitude of 1982 would occur once every 8 years? Are there some economic assumptions, data series, etc. to support this assumption? Has the PBGC identified any economic variable directly related to its claims history?

The assumption that extremely large claims would occur once every 8 years is based on PBGC's history, i.e., the \$260 million in net claims incurred in 1982, PBGC's eighth year. The current wisdom is that business cycles recur about every 3-5 years, but vary considerably in severity and duration. Projecting unusually large claims every 8 years does not seem unreasonable in this context.

Unfortunately, the PBGC has not been able to establish a reliable predictive relationship between its claims and economic variables. PBGC's 1982 premium study examined PBGC's single-employer net claims against a number of economic variables--

- Unemployment rate
- Index of credit rationing
- Current liabilities of business failures
- Capacity utilization in manufacturing
- Gross National Product, current and real
- Corporate profits with inventory valuation adjustment and capital commercial bank rate
- Money Supply (M2)
- Current liabilities of business failures, \$100,000 or over per firm
- Business failure rate, per 10,000 enterprises

Most of these variables were strongly trended and moved in tandem with each other. The unemployment rate, which had been seen to have some predictive value in PBGC's 1977 premium study, was statistically significant in the 1982 study. Current liabilities of business failures was also statistically significant. However, the relationships were weak and neither variable showed enough correlation with net claims to be a good predictor. The best predictor proved to be a net claims trend variable and a seasonal adjustment dummy variable.

We hope this information will be helpful to the Subcommittee in understanding the basis and urgent need for increasing the single-employer premium rate to \$7 for plan years beginning on or after January 1, 1984.

Yours sincerely,

Charles Tharp
Charles Tharp
Executive Director

CPRD:GS:cj

Chairman RANGEL. The Chair is glad to call the U.S. General Accounting Office, Franklin A. Curtis, Associate Director, Human Resources Division, and he has brought with him Harry Coffman, Group Director; Christopher Doyle, Actuary; and Paul R. Reynolds, Evaluator.

You have heard the testimony and your group, more than probably most agencies, has been following this very closely. It is my understanding that you generally support the thrust of the proposal that is before the Congress.

What would be helpful to us is if you could summarize your testimony and try to respond to what appears to be the concern of all of the members of the subcommittee. But again, you are not restricted to that suggestion. You can testify as you think would be in the best interest of the subcommittee. And we thank you for making yourselves available.

STATEMENT OF FRANKLIN A. CURTIS, ASSOCIATE DIRECTOR, HUMAN RESOURCES DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY HARRY F. COFFMAN, GROUP DIRECTOR; CHRISTOPHER DOYLE, ACTUARY; AND PAUL R. REYNOLDS, EVALUATOR

Mr. CURTIS. Thank you, Mr. Chairman.

I will summarize my statement, which will provide more opportunity for questions from yourself and other members of the subcommittee.

Chairman RANGEL. At this point, with unanimous consent your entire statement will be placed into the record.

Mr. CURTIS. Mr. Chairman and members of the subcommittee, we are pleased to be here today to discuss the Pension Benefit Guaranty Corporation's present request for a \$7 premium rate for its single employer pension plan insurance program.

As you know, our November 1983 report to the Congress addressed legislative changes needed to financially strengthen the single employer insurance program and the Corporation's request, at the time, for a \$6 premium rate.

The report provided the Congress with several options for reducing the program's exposure to unfunded pension liabilities of terminating plans. However, we concluded that such changes alone would not eliminate the program's deficit without increasing the program's premium rate to \$6, and that implementation of procedures for timely future adjustment of the program's premium rate were needed.

I would now like to discuss several issues relating to the insurance program's premium needs in a little more depth and provide you with our views on the Corporation's current \$7 rate request.

Since its inception, the single employer insurance program has operated at a deficit because claims for terminating plans have exceeded premium collections. Although the deficit has now grown to an estimated \$400 million, the program's liquidity has not been jeopardized in the short term. However, the present \$2.60 premium rate is not expected to produce sufficient revenue to fund benefits of insufficient plans over the long term.

As a result, the program's financial condition will continue to weaken. If the premium is not increased soon, plans established in the future could be adversely affected because they would have to pay a rate substantially higher than \$7. In the private sector, such deficits are avoided because State insurance departments require insurance companies to maintain assets at least equal to their liabilities.

The premium rate needed to finance the program is difficult to predict with certainty because major components of the premium are based on subjective assumptions and predictions of future events. These components include projections of future claims, the amount needed to retire the program's deficit, numbers of future participants for whom premiums will be paid, and administrative expenses.

Claims from terminating plans are the program's largest annual cost and are the most difficult to predict because forecasting methodologies are based on the presumed relationship between future claims and the program's past experience or other economic variables.

The annual cost to retire the deficit can also vary significantly depending on the period selected for repayment. Each \$34 million difference in the claims projection and the annual deficit payment leads to a \$1 change in the premium rate.

The Corporation's \$6 premium request in May 1982 was based on the program's experience through fiscal year 1981. The premium request has been raised to \$7 because the program's claims in fiscal year 1982 were significantly higher than originally projected for the \$6 rate.

For its \$7 request the Corporation extended the period used to project claims and administrative costs and to retire the deficit from 5 years to 15 years. If this period had remained at 5 years as used in the \$6 rate request, an \$8.50 premium would now be required.

We recognize that there are substantial uncertainties in arriving at a premium rate and believe that the \$7 premium proposed by the Corporation is the lowest that should be provided at this time. However, regardless of the rate that is approved, we believe that the size of future rate increases can be minimized, and the insurance program placed on a sounder financial basis by timely evaluation and adjustment of the premium rate.

In our 1983 report, we suggested that the Congress consider requiring the Corporation to provide information in its annual report to the Congress on the adequacy of its existing premium rate, including recommended changes when warranted or providing an automatic annual adjustment to the premium rate. We continue to believe that one of these options should be implemented.

This concludes my summary, Mr. Chairman, and we would be glad to answer any questions that you or other members of the subcommittee might have.

[The prepared statement follows:]

STATEMENT OF FRANKLIN A. CURTIS, ASSOCIATE DIRECTOR, HUMAN RESOURCES
DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee, we are pleased to be here today to discuss the Pension Benefit Guaranty Corporation's present request for a \$7.00 premium rate for its single employer pension plan insurance program. As you know, the Employee Retirement Income Security Act of 1974 established the Corporation to administer a self-financing program which insures the benefits of about 29 million participants in 106,000 private pension plans. When a plan terminates with insufficient assets, the Corporation assumes responsibility for paying participants guaranteed benefits. Shortfalls in a terminating plan's assets are financed primarily from premiums paid annually by ongoing plans. The premium rate was originally set in 1974 at \$1.00 per plan participant and was raised to \$2.60 in 1978. In May 1982, the Corporation, to reduce its growing deficit, requested congressional approval to increase the premium rate to \$6.00, effective January 1, 1983, which has not been granted.

On November 14, 1983, we issued a report to the Congress which addressed legislative changes needed to financially strengthen the single employer insurance program. The report provided the Congress with several options relating to the level of benefits insured, plan funding standards, and employers' liability at termination which could be used to reduce the program's exposure to unfunded pension liabilities of terminating plans. However, we concluded that such changes alone would not eliminate the program's deficit.

The report also assessed the Corporation's May 1982 request for a \$6.00 premium rate which it said would retire its deficit in 5 years. We observed in our report, however, that because of increased claims against the program since the premium increase was requested, a premium of about \$7.50 would be needed to retire the program's deficit within 5 years. Based on our assessment of the \$6.00 premium request, we concluded that (1) the Corporation's methodology for developing the premium rate was reasonable, (2) a premium increase to not less than \$6.00 was needed, and (3) procedures to assure timely future adjustment of the program's premium rate should be considered.

I would now like to discuss several issues relating to the insurance program's premium needs in a little more depth and provide you with our views on the Corporation's current premium rate request. In preparing for these hearings, we used information provided by the Corporation to assess the Corporation's \$7.00 request in addition to updating our work on the \$6.00 premium request.

PREMIUM RATE INCREASE IS NEEDED TO REDUCE PROGRAM'S DEFICIT

Since its inception, the single employer insurance program has operated at a deficit because claims from terminating insufficient plans have exceeded premium collects. Although the deficit is growing, the program's liquidity is not jeopardized in the short term. However, the present \$2.60 premium rate is not expected to produce sufficient revenue to fund benefits of insufficient plans over the long term. As a result, the program's financial condition will continue to weaken. If the premium is not increased soon, plans established in the future could be adversely affected because they would have to pay a rate substantially higher than \$7.00. In the private sector, such deficits are avoided because state insurance departments require insurance companies to maintain assets at least equal to their liabilities.

In general, the program incurs a claim when a plan terminates with insufficient assets to pay guaranteed benefits. The Corporation uses data available from the plan to compute the estimated future benefits payable to the plan's participants. The Corporation's deficit reflects the difference between the total of such estimated future benefits for all terminated plans with insufficient assets and the Corporation's total assets—including assets of such terminated plans, premium collections, and investment income.

Despite an increase in the premium rate from \$1.00 to \$2.60 on January 1, 1978, the Corporation estimates that the program's current deficit exceeds \$400 million and could exceed \$600 million by the end of 1985. To date, investment earnings and premium collections have exceeded annual benefit payments and administrative costs. However, these disbursements are expected to exceed premium revenue and investment earnings for the first time during this fiscal year.

The funding of the program contrasts with general insurance industry standards which do not permit private insurers to operate at a deficit. In order to comply with state regulatory standards, private insurers must report their financial condition annually to state insurance departments. If a private insurer's financial condition

does not meet state statutory requirements, a State may take action to protect policyholders, including possible revocation of the insurer's operating rights.

Timely implementations of rate changes is necessary to maintain the program's assets at a level sufficient to pay liabilities. At the time the first premium increase to \$2.60 was approved, the Corporation estimated that it would provide sufficient revenue to retire the program's estimated deficit of \$59.4 million on January 1, 1978 within 4 years. However, unexpectedly high claims substantially increased the program's deficit.

In December 1980, a Corporation study showed that a \$4.66 premium would be needed to eliminate a then estimated deficit of \$157 million within 5 years. However, the Corporation did not propose a premium increase until May 1982. Had the \$4.66 premium rate been requested and made effective on January 1, 1981, about \$200 million in additional assets would have been generated during the subsequent 3-year period. As a result, a lower premium would now be needed. In addition, the program's costs would be more equitably allocated between then existing plans and plans established subsequently.

PROGRAM'S PREMIUM REQUIREMENTS DIFFICULT TO PREDICT WITH CERTAINTY

The premium rate needed to finance the program is difficult to predict with certainty because major components of the premium are based on subjective assumptions and predictions of future events. These components include projections of future claims, the amount needed to retire the program's deficit, numbers of future participants for whom premiums will be paid, and administrative expenses.

Claims from terminating plans are the program's largest annual cost and are the most difficult to predict because forecasting methodologies are based on the presumed relationship between future claims and the program's past experience or other economic variables. To illustrate how claims projections can differ, our actuaries used three assumptions about the program's future claims and calculated that the average annual claims could range between \$81 million and \$183 million over the next 5 years.

For example, the average annual claims would be projected to be \$81 million if they were assumed to equal the average annual amount of claims experienced since the program began in 1974. Under this assumption, the strong upward growth in the program's claims is ignored—which we believe would be unreasonable—and projected claims are lower than the program's actual claims experience during the last 5 years. The average annual claims projection would be increased from \$81 million to \$122 million if it is assumed that claims for the next 5 years would equal the average claims level over the last 5 years. Finally, the claims projection would be increased from \$122 million to \$183 million if the growth in claims experienced during the program's last 6 years is assumed to continue for the next 5 years. If this growth should continue, claims would be even higher than those experienced during the last 5 years. Each \$34 million increase or decrease in projected annual claims has a \$1.00 effect on the premium.

The annual cost to retire the deficit can also vary significantly depending on the repayment period. For example, the annual cost to retire an estimated deficit of \$400 million would be \$104 million over 5 years compared to \$64 million for 10 years and \$51 million for 15 years. However, the reduction in the annual cost becomes less significant as periods longer than 15 years are used. For example, a 30-year repayment period would result in an annual cost of \$41 million. As with the claims projection, each \$34 million difference in the annual deficit payment leads to a \$1.00 change in the premium rate.

The quality of the Corporation's data raises an additional uncertainty about the cost to retire the deficit. The accuracy of the Corporation's accounts, including the accumulated results of operations (the deficit), was not determinable for financial statement reporting purposes. However, the preliminary deficit estimate of over \$400 million through the end of 1983 is the only information available for determining the premium. For each 10 percent variation in a deficit of \$400 million, the required premium changes by \$.31 for a 5-year deficit repayment period and \$.13 for a 15-year period.

The premium requirements are based on a projection of the number of participants for whom premiums will be paid. From 1975 through 1981, the Corporation estimated that insured participants increased at an annual rate of 1.1 million. Any major change in this growth rate could have an effect on premium requirements. For example, if the projected participant growth rate is cut in half over the next 5 years, the required premium would increase by \$.43 assuming the same absolute amount of program costs.

The program's administrative expenses are another source of uncertainty in developing the required premium. Historically, the program's expenses have grown at an average of about 14 percent a year. Any change in the assumed future growth of program expenses could affect premium requirements. For example, if the growth rate over the next 5 years is cut in half, the required premium decreases by \$.16.

ANALYSIS OF THE CORPORATION'S PREMIUM REQUEST

The Corporation's \$6.00 premium request in May 1982 was based on the program's experience through fiscal year 1981. The premium request has been raised to \$7.00 because the program's claims in fiscal year 1982 were significantly higher than originally projected for the \$6.00 rate. For its \$7.00 request, the Corporation extended the period used to project claims and administrative costs and to retire the deficit from 5 years to 15 years. If this period had remained at 5 years as used in the \$6.00 rate request, the Corporation estimates that an \$8.50 premium would now be required.

The attached exhibit shows the portion of the \$6.00, \$7.00, and \$8.50 premiums needed to finance claims, repay the deficit, and pay administrative expenses. For all rates, the Corporation estimated that the number of participants for whom premiums would be paid would grow at a rate of 1.1 million a year.

The Corporation's \$6.00 premium rate included about \$2.00 to retire the January 1, 1983 estimated deficit of \$236 million over 5 years. In contrast, the Corporation estimates that \$1.50 of the \$7.00 premium is needed to retire the program's estimated January 1, 1984 deficit over 15 years. The Corporation has not finalized computation of the deficit and for purposes of computing its premium needs, the Corporation has projected a deficit of \$462 million as of January 1, 1984. On the basis of this deficit, extending the period from 5 years to 15 years reduced the portion of premium needed for retiring the deficit even though the total projected deficit almost doubled. If the period had remained at 5 years, about \$3.50 rather than the present \$1.50 would be needed to retire the \$462 million projected deficit.

If the premium rate increase is not made effective on January 1, 1984, the program's deficit could increase by about \$140 million by the end of 1984 because of premium revenue foregone. As a result, about \$2.00 rather than \$1.50 would need to be included in the premium rate to retire the higher deficit within 15 years as presently proposed.

While the \$6.00 premium included about \$3.00 for the claims projected over a 5-year period, the Corporation estimates that \$4.50 of the \$7.00 premium will be needed to pay for projected claims for the next 15 years. About \$1.00 of the \$1.50 increase reflects the rise in claims since the earlier request and \$.50 results from the Corporation's switch from a 5-year to a 15-year projection period. As a result, \$4.00 rather than \$4.50 would be needed to pay projected claims over a 5-year period.

Although the Corporation estimated that \$1.00 of both the \$6.00 and \$7.00 premiums would be needed to cover future administrative expenses, the underlying expense assumptions have been changed for the \$7.00 request. In addition to extending the expense projection period from 5 to 15 years, the Corporation lowered the projected expense annual growth rate from 9 percent to just over 2 percent. If the 9 percent assumption had been maintained, about \$1.50 would not be needed to cover future administrative expenses for 15 years or about \$1.00 for a 5-year period.

GAO OBSERVATIONS

In our November 1983 report, we concluded that the Corporation's methodology in its May 1982 study was reasonable. The proposed \$6.00 premium was designed to cover claims, administrative expenses and retire the deficit in 5 years and was to be effective on January 1, 1983. We observed, however, that because of higher than expected claims in 1982, a premium of about \$7.50 would be required to achieve the same objective. Presently, because the effective date of the requested premium increase is being extended to January 1, 1984, a premium rate of \$8.50 may now be needed to cover claims, administrative expenses, and retire the deficit within 5 years.

We recognize that there are substantial uncertainties in arriving at a premium rate and believe that the \$7.00 premium proposed by the Corporation is the lowest that should be provided. However, regardless of the rate that is approved, we believe that the size of future rate increases can be minimized and the insurance program placed on a sounder financial basis by timely evaluation and adjustment of the premium rate. In our 1983 report, we suggested that the Congress (1) requiring the Corporation to provide information in its annual report to the Congress on the

adequacy of its existing premium rate, including recommended changes when warranted, or (2) providing an automatic annual adjustment to the premium rate. We continue to believe that one of these options should be implemented.

This concludes my testimony Mr. Chairman. We would be glad to answer any questions you or other Members of the Subcommittee might have.

PENSION BENEFIT GUARANTY CORPORATION'S PREMIUM ESTIMATES IF EFFECTIVE JAN. 1, 1983, OR
JAN. 1, 1984

	Premium requested		Premium needed: 5-yr. projection Jan. 1, 1984
	5-yr. projection Jan. 1, 1983	15-yr. projection Jan. 1, 1984	
Finance future claims.....	\$3.02	\$4.50	\$4.00
Retirement of deficit.....	1.95	1.50	3.50
Administrative expenses.....	.97	1.00	1.00
Total.....	¹ 5.94	7.00	8.50

¹ Rounded up to \$6 by the Corporation.

Chairman RANGEL. Mr. Duncan.

Mr. DUNCAN. I do not believe I have any particular questions, Mr. Chairman, at this point, thank you.

Chairman RANGEL. Mr. Gibbons.

Mr. GIBBONS. I see on page 3 of your statement, the next to the last paragraph, "To date, investment earnings and premiums collected have exceeded annual benefit payments and administrative costs. However, these disbursements are expected to exceed premium and revenue investment earnings for the first time during this fiscal year."

And then you go over on page 4 and you say, "A Corporation study showed that a \$4.66"—"In December 1980, a Corporation study showed that a \$4.66 premium would be needed to eliminate a then-estimated deficit. However, the Corporation did not propose a premium increase until May 1982."

So from December 1980 to May 1982 they knew that a \$4.66 premium increase would take care of the projected deficit.

Now you are saying a little later on in that same paragraph on page 4, a lower premium would be needed now if they had made the appropriate move.

Do you want to elaborate on that?

Mr. CURTIS. Yes, sir. We believe that one of the problems which has led to the deficit over the years is the fact that the premium, when established, has been allowed to go on for significant periods of time, even though conditions may have changed. For example, the reference you just made, the difference between establishing the \$4.66 rate at that time and now represents about half the current deficit or about \$200 million that would have been collected.

We believe that if the Corporation were required to make an assessment annually and report that to the Congress, together with recommendations on premium changes, that both employers and the Corporation would benefit.

If you have a premium rate which is too high and it is not reassessed for a long period of time, you then require higher, as you called it, "taxes" from the individuals who have to pay those rates, whereas if it is understated and continues for a long period of time,

as we believe has happened in the case of the \$2.60 rate, you incur substantial underfunding and a deficit.

Mr. GIBBONS. In your study of the agency did you determine why they delayed so long to ask for a rate increase?

Mr. CURTIS. We did not get a specific answer. I think that the Corporation has tended to be optimistic. There has been limited data also because of the length of time of the program. And I think historically the projections that they have made have been more on the short side than on the far side, therefore understating what their needs are.

Mr. GIBBONS. Did the Corporation agree with your analysis or did they dispute your analysis about the fact that they knew in 1980 that they would need an increase? I am trying to get at management of the Corporation now.

Mr. CURTIS. We discussed this with them as late as last Friday, and we heard no objections to these facts.

Mr. GIBBONS. Was it because of management in the Office of OMB that they could not get the clearance to come here and ask for a rate increase, or was it just bureaucratic ineptness within the Corporation?

Mr. CURTIS. I do not know that, Mr. Gibbons, but I think Mr. Reynolds has some additional information he can provide.

Mr. GIBBONS. I would like to hear from Mr. Reynolds, and I want to know where the problem arose.

Mr. REYNOLDS. The \$4.66 rate in December 1980 was a rate that was entirely calculated by the Corporation, and we analyzed that. They had done other rates into early 1981, and we also looked at those, and they came to the same conclusion. However, we did not collect specific information on the reason why they did not come forward.

Mr. GIBBONS. There was a 2½ year lag in here, 2¼ year lag, is that right, between the time they recognized a rate increase was desirable or needed and the time they asked for it?

Mr. REYNOLDS. A year and a half, I believe, all of 1981 and the first 5 months of 1982.

Mr. GIBBONS. I got you. A year and a half. OK. Well, why did it take so long?

Mr. REYNOLDS. I think one possible reason is the lag in closing their financial statements. There was at that time a rather long lag between the end of a fiscal year and when they had their financial statements finalized. That could have been a consideration.

Mr. GIBBONS. Well, are we chasing an impossible dream here? Should the Federal Government really be out trying to guarantee defined benefit plans when we have so little say as to what the contents of those defined benefit plans are and the contributions are to them, or should we be insuring them at all, or should we be just trying to ensure defined benefit plans against the defalcation or something similar?

Mr. REYNOLDS. We did not assess that at all, Mr. Chairman.

Mr. COFFMAN. We accepted the fact that ERISA provided for insuring of defined-benefit pension plans.

Mr. GIBBONS. You might get in trouble with Congress, but every now and then you ought to question our judgment as to whether we are doing the right thing. I am not sure we did the right thing.

Now, as I say, I played a role in putting this PBGC thing together, but I am questioning my own judgment now as to whether we really ought to have it for defined benefit plans, because the Government takes a rather lackadaisical attitude toward the defined benefit plans, thinking that there will be some discipline in the management and in the labor-management relationship between the two. But obviously, there has been very little discipline.

Mr. REYNOLDS. That is a significant concern. We addressed that in our 1983 report. We pointed out that the Corporation did not have any control over the benefit levels that were promised in the plans, the way the plans were set up, or the actual contributions that were made, other than the minimum funding standards which ERISA established.

Those were major concerns in our 1983 report: the low level of funding which the terminating plans had which caused the large losses on the Corporation.

Mr. GIBBONS. Well, I'm glad to hear you express that doubt, too, because, you know, one, these are voluntary plans. Nobody's required to have one. Two, we thought, I guess rather naively or maybe uneducatedly, that there would be some discipline after ERISA, and we put a little discipline on, but not very much.

We sure received a lot of complaints from private plan people after that stating we had been too hard. But I just do not know whether we ought to be in the business at all of guaranteeing defined benefit plans, because it seems that we are almost defining a will-o'-the-wisp, trying to predict too many things that are too uncertain.

Maybe we just ought to be in the guarantee business of defining defined contribution plans, not defined benefit plans, because some of these defined benefit plans are dreaming. They are just dreaming.

And I do not know whether we can really properly insure—what we are doing; we are taxing the hardworking, successful people for the benefit of the irresponsible dreamers in the system, it seems to me, and that is not good for the country as a whole.

It seems that we are propping up wishes and dreams, and we are requiring hardworking people to pay the burden for it, those who are not really on a fishing trip or a wild goose chase or something like that.

Mr. CURTIS. Mr. Gibbons, we would certainly agree with you that it is a valid matter for consideration by the Congress.

Mr. GIBBONS. Well, that is going to be in the back of my mind when I vote any pension increase. Maybe the best thing to do is to liquidate this Corporation and say we made a mistake.

Mr. Chairman, thank you.

Chairman RANGEL. You said that was a valid matter for consideration by the Congress, but what is your opinion on Mr. Gibbons' remarks about whether or not we should be in the pension guaranty business?

Mr. CURTIS. Mr. Chairman, that certainly is a matter of policy for the Congress, and we have not studied that issue specifically in terms of risk-related; therefore, we do not have any basis for commenting one way or the other on that other than the fact that it

certainly is a question to be considered and one which is being discussed, I understand, certainly by Mr. Gibbons and others.

Chairman RANGEL. Well, do you believe that the legislation that has been enacted along with the reforms that are now before us would encourage the establishment of private pension plans?

Mr. CURTIS. On a risk-related basis?

Chairman RANGEL. Yes.

Mr. CURTIS. I guess it would depend on how much cost that would place on those who would be in the high risk as to whether they would still consider that they should have a pension plan, or whether those increases, because of the high risk might influence them to consider, as part of their total benefit package, less benefits to compensate for whatever premium they might have to pay.

Chairman RANGEL. Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

We have a copy of a report the GAO issued on November 14, 1983, entitled "Legislative Changes Needed to Financially Strengthen Single Employer Pension Plan Insurance Programs."

Mr. CURTIS. We did include those, Mr. Anthony.

First of all, let me say that we would support the legislative changes mentioned in the testimony by PBGC. There are some others that we made one of which I think is very important from our standpoint, and that is the need to require PBGC to do an annual assessment of the premium needs and provide that information to the Congress so that on an annual basis, at least at this point in time, these can be reassessed.

Because of the lack of experience with the program and because of the uncertainties that are associated with this type of a program, trying to determine what kind of claims will come in, how many participants you will have in the future in terms of premium payments and so forth, we believe that it is really essential to take a look at this at least once a year.

That way, even if your assumptions are incorrect or if you had some significant changes that affect your trend analysis or forecasting, you can adjust those timely so that people who are paying these claims will not have to continue the premium payments for long periods of time without adjustment or, as I mentioned earlier, the Corporation will not suffer because it is losing revenues that should otherwise be obtained.

Mr. Coffman has, I think, some information as to the other recommendations we made over and above those PBGC made.

Mr. ANTHONY. Before he does that, I would like to ask you, based on the GAO report, to elicit for the record what you consider to be the major weaknesses in the single employer program. I assume that going to annual assessment of need would be an answer to that question.

Mr. CURTIS. I think if I had to pick out the one most important thing that they need to do, I believe that's it.

Mr. ANTHONY. An annual assessment?

Mr. CURTIS. That is right. Therefore, as I said, it brings you more experience each year on which to base your projections and provides an opportunity to adjust the premium rate if you so desire. It does not mean and we are not recommending that there would be a premium change every year, but that it be assessed and that the

Congress be fully informed as to the status of the Corporation in terms of the premium review.

Mr. ANTHONY. You are basically saying that you want this company to operate just like a private insurance company.

Mr. CURTIS. We would certainly—

Mr. ANTHONY. You would ask it to go to the Congress for rate adjustments just like a private for-profit insurance company would have to go to the State agency for a rate increase to make sure that its projected assets were current with its projected liabilities, is that right?

Mr. CURTIS. Yes, sir. The other alternative—

Mr. ANTHONY. Is there a unanimous feeling out in the marketplace that that is the correct approach? Does everybody agree with that?

Mr. CURTIS. Certainly the private insurance companies agree with that. We have not done any work to determine whether there is a general consensus in terms of whether that is appropriate for PBGC.

Tied to that recommendation was the other alternate, Mr. Anthony, that it be an automatic increase. And that's a matter I think for the Congress to decide as a policy matter whether they want to give that responsibility to PBGC or share in reviewing the condition before—

Mr. ANTHONY. I am going to be like Mr. Gibbons and tell you one of my pet peeves, that being automatic increases that we have passed in previous law. The policy has not done anything but wreck our whole budget.

Personally, I think it takes away the Congress discretion to take a look at it and make those hard decisions. So I, for one, would have a very hard time agreeing to an automatic increase. In fact, I am supporting legislation to take out automatic increases all through the budget and force us to take a look at them. If we decide to increase on an annual basis, so be it, but we should have some periodic review.

Are there any other recommendations that you would make, that you would list as very critical?

Mr. CURTIS. As I mentioned, Mr. Coffman I think can respond to that for you.

Mr. COFFMAN. In addition to the legislative suggestions included in the Corporation's statement, we believe that Congress might wish to consider reducing the period for amortizing the unfunded actuarial liabilities of the plan.

At this point in time, when a plan is established, if they give credit for past service benefits, they have up to 30 years to pay those benefits. You may wish to reduce that period.

We also believe that you should consider extending the 5-year phase-in period for guaranteeing benefits. The previous example I gave where you have 30 years to amortize or retire or fund your past service costs, they are 100 percent insured by the Corporation within 5 years and another 25 years can elapse without funding of the benefits.

We think you should also consider excluding coverage of benefits during the years for which IRS grants a waiver to a plan sponsor. During that period of time, no contributions are coming into the

plan, and yet, PBGC is required to insure the benefits that accrue to participants during that period of time. Those are the three things that we would suggest in addition to those that are already proposed by PBGC.

Mr. ANTHONY. Let me see if I understand about the amortization of benefit improvements. What was the timeframe that you are suggesting?

Mr. COFFMAN. Well, we did not suggest——

Mr. ANTHONY. You made no recommendation.

Mr. COFFMAN. No, sir. The fact is, though, that the benefits are fully guaranteed within a 5-year period after they are promised.

Mr. ANTHONY. What would happen if we moved that to 15 years?

Mr. COFFMAN. It would improve the funding of the plans.

Mr. ANTHONY. Is that a rational approach?

Mr. COFFMAN. We feel it is. It would reduce the risk to the Pension Benefit Guaranty Corporation.

Mr. ANTHONY. In all of your recommendations and your studies do you see any problem that presently exists as far as employers dumping their problem over to the Corporation, and do you see any problems with the rating of the assets or the recapture problem?

If you have any comments on either one of those two issues, I would appreciate it.

Mr. REYNOLDS. As far as the employers dumping, we have looked at and reviewed a lot of the records that the Corporation has for what they consider to be abusive claims. A lot of things were alluded to in their statement or are already testified to—situations where a financially stronger employer would transfer his unfunded pension liabilities in a sale to a weaker employer who would then within a year or two terminate the plan. Under the program's present procedures, PBGC can only collect 30 percent of the net worth of the weaker company and cannot go and try to collect any unpaid pension liabilities from the original sponsor.

Mr. ANTHONY. Does that bother you?

Mr. REYNOLDS. I think, as we have said in our report, and we have discussed these in our report, we believe that this is a loophole that is being used, and it is something that the Congress should consider correcting about the program.

Certainly if you made the original sponsor liable, you would increase the recovery of funds upon plan termination for the Corporation, and it would help their financial condition.

Mr. ANTHONY. What about the recapture of assets? We have read some fairly interesting news accounts where plans have been shut down—well, reversions. We will get on the same wavelength here.

Mr. COFFMAN. Mr. Anthony, we have not studied that at all. We did consider it initially when we planned the report we are talking about, but the courts were quite clear in their decisions that the reversions were in accordance with the law. And ERISA does permit it, and therefore, we had no basis for really going into it further. So we really have no opinion on it at this time, sir.

Mr. ANTHONY. So you have taken no position on that issue, and you just say that that is a policy that this Oversight Subcommittee can take a look at and report to the full committee and to the Congress?

Mr. COFFMAN. We clearly feel it is a matter that the Congress should consider.

Mr. ANTHONY. I want to go back and ask you something that Mr. Gibbons mentioned a little while ago, and that is the link between the premium increase and remedial legislation to correct what you consider program weaknesses.

Do you consider that it is essential to have that link?

Mr. CURTIS. Mr. Anthony, we believe that both are essential. We do not necessarily believe that they have to be linked together. I think the biggest concern that we would have is that if in the linking it would delay further the increase in the revenues through the premium, it would only work to increase the deficit.

That is not to say that we do not consider both important or that they both should not be done. We believe they both should take place, but we do not think they have to be done necessarily as one action.

Mr. ANTHONY. Mr. Chairman, I just have one final inquiry, if I can find the page. Some place in your testimony you talk about income and outgo. I think it is on page 2.

Although the deficit has grown, the program's liquidity is not jeopardized in the short term. Can you define "short term?"

Mr. CURTIS. As of right now, the corporation has about \$1 billion in assets, and it is paying out something close to \$180 million plus a year. Therefore, at the moment, and in the short run, they can still continue to pay their expenses as well as the benefits. However, as PBGC mentioned in its testimony, they are fast approaching the point where revenues are not going to equal or exceed payouts, which puts them in more of a deficit position without the premium increase.

Mr. ANTHONY. Then you go on and say, if the premium is not increased soon, plans established in the future could be adversely affected because they would have to pay a rate even substantially higher than the proposed \$7.

Mr. CURTIS. That is correct.

Mr. ANTHONY. That confuses me, if you have no problem in the short term and you are only talking about the long term.

Mr. CURTIS. The point we are trying to make is the same point that is brought out by the fact that they did not adopt the \$4.66 premium when they were aware of the need. This delay increased the amount of the deficit by at least \$200 million during that period, so that when they finally had to request a premium increase, it was higher than if they had had a lesser amount earlier. As you go along, the sooner you collect what you know you need, the less you are going to have to ask for each time if you do it on a more appropriate or annual basis, as we are suggesting.

Mr. ANTHONY. Is that just because of the earnings from those amounts?

Mr. CURTIS. And simply the collection of those amounts that are not collected for those periods in time in which the premium is not increased, and for that particular period it amounted to about \$200 million in premium revenues that they did not obtain.

Mr. ANTHONY. I yield back, Mr. Chairman.

Chairman RANGEL. Mr. Duncan?

Mr. DUNCAN. Thank you, Mr. Chairman. I have only two or three short questions.

Do you consider the \$7 request conservative or generous?

Mr. CURTIS. We believe that it is probably the minimum amount that should be increased at this point based on our study of it.

Mr. DUNCAN. What would a \$5 rate do to the program?

Mr. CURTIS. Mr. Doyle, who is our actuary, can probably better answer that question, Mr. Duncan.

Mr. DOYLE. Based on the Corporation's latest projections, \$5 would not be sufficient in this year or in fact any of the next 5 to 15 years to cover claims and administrative expenses.

Mr. DUNCAN. Well, what assurances are there that a \$7 premium would be adequate? If it is the appropriate rate in 1984, how many years is the \$7 likely to continue to be adequate in the future?

Mr. DOYLE. We cannot say, and it is because of that that we suggest a—

Mr. DUNCAN. You can say if we do not, but you cannot say if we do give it to you?

Mr. CURTIS. I think, Mr. Duncan, the reason we have recommended so strongly, and as you have probably heard me say several times, we believe that is one of the reasons why it is necessary to reassess it each year, so that you are better able to tell when you need to make increases or decreases, and then take those actions appropriately rather than have it run for a length of time without really knowing what it is doing.

Mr. DUNCAN. Well, do you think you will be back again next year asking for another increase?

Mr. CURTIS. I cannot say with certainty when they have the additional experience of this year whether the premium should be increased or decreased at this point in time.

Mr. DUNCAN. I would not look for a decrease, anyway?

Mr. CURTIS. That might not happen.

Mr. DUNCAN. Who bears the cost of the single employer insurance program?

Mr. CURTIS. Who bears the cost?

Mr. DUNCAN. Yes, and to what degree?

Mr. CURTIS. The employers who pay the premium per person.

Mr. DUNCAN. Do they pay it all?

Mr. DOYLE. Not completely, no. There was a study done by an actuary with the Corporation, but I think he did it personally. I do not think it was a Corporation study. He estimated that 37 percent of the cost of benefits is borne by employers who are paying the premiums, 37 percent is provided by terminating plans' assets, and 25 percent is borne by participants in benefits that they do not get as a result of the guarantees. They do not get all their vested benefits.

Mr. DUNCAN. What effect does increased employment have on the plan, more people going to work every day? There are five million more working today than have ever worked in the history of the country. What effect does that have? Does that get additional funds into the program, having new and more employees in the economy?

Mr. DOYLE. I guess if contributions were made in respect of those employees, perhaps if participation increased—are you suggesting

that there would be more people in the defined benefit plans? If that were the case, the per capita cost would perhaps decline with more participants over which to spread the cost.

Mr. DUNCAN. Thank you.

Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Pickle?

Mr. PICKLE. Mr. Chairman, I have only one question. I am sorry I have not been able to be here for all of this hearing, but I have had to attend a session of the Rules Committee.

I assume, GAO recommends the premium increase from the \$2.60 to the \$7 level. Is that correct?

Mr. CURTIS. Yes, sir, we do.

Mr. PICKLE. Do you have any hesitancy about the cost? It is almost triple the current amount.

Mr. CURTIS. Not from that standpoint. Mr. Pickle, I think the problem in terms of the significant increase is because the premium rate was not adjusted sooner.

Mr. PICKLE. Is there any other alternative for this problem?

Mr. CURTIS. Any other alternative than the premium rate increase? At this time, no, sir. I believe that that is necessary to write off the deficit. Now, the legislative changes that have been discussed would have some future effect on what the premium rate might be, and they should tend to reduce it in some part.

Mr. PICKLE. Well, if we have a deficit now, and this occurred during relatively good times, and you are asking to increase the premium from \$2.60 up to \$7. Is it to be anticipated that the cost then would go up again? What is the limit, the ceiling on this type of expenditure?

Mr. CURTIS. The need for the \$7 again is not so much in terms of the economic times as to the fact that it was identified but not raised earlier and collected. That represented about \$200 million of the present deficit. As to the future, it depends largely on the number of claims that come in, and the size of those claims; and that is a very difficult area to predict or project.

Mr. PICKLE. Well, the PBGC must be kept solvent, and it has served a very useful purpose, but there is a point beyond which we cannot continue to raise these premiums. If we have tripled the cost, in this short period of time, then that sounds an alert signal to most of us of what this program will eventually cost.

There must be a ceiling to it. I do not know if there is any alternative to an increase, but I think there is a great difference between just recommending a premium increase and having a program that has stability over the long range, and that is what we must consider.

Mr. CURTIS. I think the legislative changes that we have discussed will help the stability of the program from abuses or just simply loopholes that exist in the law, but it will depend entirely on the experience of the terminating plans as to what that ultimate rate will be.

However, again, I would just like to reiterate that we believe that an annual assessment is essential so that the rates do not jump in such significant terms from period to period of adjustment, that they are leveled out over time, and therefore work to the benefit of those who pay it as well as to the benefit of the Corporation.

Mr. PICKLE. I was not here, as I said, earlier. Have we had representation from the singler employer plan groups in protestation of this increase?

Chairman RANGEL. Not yet.

Mr. PICKLE. Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Duncan earlier asked the Corporation whether or not if the Congress had prevented the abuse by legislation, they would still be before the committee asking for an increase in premium. How would you respond to that, based on your analysis of their experience?

Mr. CURTIS. Mr. Chairman, we believe they would still have to be here to request a premium increase. Now, what effect from the beginning the absence of those particular items would have had on the premium rate, I do not have any figures on that. The estimate, I think, has been something like maybe 20 percent of the deficit, but we do not have any precise figures, but to answer your question, yes, we believe they still would have had to ask for a premium increase even if those had not existed.

Chairman RANGEL. And roughly speaking, in terms of presenting legislation with some degree of balance, you are saying, are you not, that roughly 20, 25 percent of future losses would be abuse cases if we did not move to remedy the loopholes?

Mr. CURTIS. One of the problems in making that assessment is that we do not know and we have seen no evidence that plans would continue to come in with those same type of abuses. If it continues at the same level, then what you are saying is correct. However, there is no assurance that you would have the same kind of experience in the future with other plans. That is something that we do not have any basis to judge.

Chairman RANGEL. Well, you read or at least heard the testimony of the corporation. Do you have any sharp disagreement with their findings as to their future needs based on your own analysis?

Mr. CURTIS. No, sir.

Chairman RANGEL. And they used an 8-year economic cycle in projecting what future terminations would be. Is that the same type of projection that you used in your analysis? And if so, is that the best thing for us to be using?

Mr. CURTIS. Mr. Doyle?

Mr. DOYLE. Well, the way they projected claims and spread the \$220 million in claims from 1982 over the next 8 years is not unreasonable. The nature of this game is sort of uncertain anyway when you try to project claims, especially given the erratic year to year experience they have had. They have had a rising trend in claims. That is clear.

But from year to year, it is hard to say what the claims will be, and I do not think we disagree with their projection of claims as it is stated now. I think it is \$186 million averaged over the next 15 years. We do not like projections like that, I think, unless they are looked at again and again, because there is no assurance what the future holds.

Chairman RANGEL. What I am looking for really is that their optimism is not completely out of line with the range in which the economists generally project our recovery or lack of it. That gives the broadest possible range that you could have.

Mr. DOYLE. I cannot speak for economists, but I do not think the optimism they show is outside a reasonable range.

Chairman RANGEL. Well, I know that you are generally reluctant to give us an opinion as to whether or not this program makes any sense at all, but I hope you will think about it. It is not going to have any political effect on what we do this year, but you know, we rely heavily on the observations made by your office, and I think all of us one way or the other appreciate the dedication and quality of work that you perform.

And the fact is that this issue is before the Congress. Do you need a formal request from a Member to give us some analysis as to what public good has been provided by this legislation and whether or not it has discouraged people from setting up pension plans?

Mr. CURTIS. One of the things that we have just started, Mr. Chairman, is a review of PBGC itself. We are in the early survey phases of that, to look at it from the standpoint of efficiency and economy, and once we have gotten more information and are further into that job, we certainly would be very happy to meet with you or any other member of the subcommittee and share our findings, and discuss what your needs might be at that time, but I think it would be beneficial to us to do some basic work first, and then see just where we are.

Chairman RANGEL. That makes sense.

Are there other questions from members of the subcommittee?

[No response.]

Chairman RANGEL. Thank you very much.

Mr. CURTIS. Thank you, Mr. Chairman.

Chairman RANGEL. Our next panel will be the president of the Employee Benefit Research Institute, located in the Nation's Capital, Dallas L. Salisbury, and Karen Ferguson, the director of the Pension Rights Center.

Both of you have heard the general thrust of the questions from members of the subcommittee, and I hope that you either heard or read the testimony of the two previous witnesses.

Where there is duplication, I will encourage you to summarize and see whether or not you can respond to the—Ms. Ferguson, after weighing your testimony, I would strongly hope that you might summarize, since both statements by unanimous consent will appear in the record—and I do hope that you might attempt to respond to some of the questions of members of the subcommittee. You may proceed in your own fashion.

STATEMENT OF DALLAS L. SALISBURY, PRESIDENT, EMPLOYEE BENEFIT RESEARCH INSTITUTE

Mr. SALISBURY. Mr. Chairman, it is a pleasure to be here today. Ms. Ferguson suggested that I go first, so I shall.

As you noted, I am with the Employee Benefit Research Institute. Prior to that, I had the pleasure of serving at the Pension Benefit Guaranty Corporation as director of policy. In fact, I recall some 7 years ago appearing before Mr. Gibbons when he chaired this committee, when the PBGC was requesting an increase in the premium to \$2.60.

I would ask that supporting documentation that I have given to the staff with my statement also be included in the record.

Chairman RANGEL. Without objection.

Mr. SALISBURY. On establishing EBRI in 1978, the first policy project conducted was a policy forum titled "Pension Plan Termination Insurance: Does the Foreign Experience Have Relevance for the United States?" Experts from a number of nations joined together to discuss their own nation's experiences with this type of insurance program. The discussion focused on basic design questions, such as alternative definitions of the insurable event, and in what cases should financial assistance be provided.

That policy forum reinforced my conviction—that dates from my work at PBGC—that pension policy must be considered in a more comprehensive manner than this nation has generally attempted. Further, it highlighted that every aspect of a benefit guarantee program is interrelated: the premium structure, the program structure, and the nature of the guarantee. In line with the questioning of the last panel, I would also suggest that other questions such as the reversion of assets are inextricably intertwined as well.

The purposes of PBGC contained in ERISA should not be overlooked. They are to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants, to maintain insurance premiums at the lowest level consistent with carrying out its obligations, and to provide for the timely and uninterrupted payment of pension benefits under plans covered by PBGC.

In Senate testimony supporting a proposed premium increase, the PBGC failed to even mention this first purpose, that of maintaining and expanding defined benefit pension plans. The General Accounting Office also did not address this purpose in their 1983 study; nor did the PBGC in its 1982 study.

The request for a premium increase of 169 percent should not be overlooked in regard to its potential consequences—if enacted without reforms—on participants of defined benefit pension plans.

If Congress hopes to maintain the PBGC as a self-financing agency, Congress must carefully consider the implications of every legislative pension policy decision for the maintenance and creation of defined benefit pension plans. Not only do they provide the funds for the PBGC, but they aid in meeting the economic security needs of millions of Americans at all income levels.

Although PBGC has sufficient financial reserves to cover its known obligations for the next several years, it does not have enough of a financial reserve today to pay all of the future benefits it is responsible for as a result of terminations of plans that are insufficient. PBGC has estimated its total reserves at the end of fiscal year 1983 at \$1.1 billion, however, which is enough to cover the current annual revenue shortfall for several years.

While use of the reserves for this purpose might not be the ideal policy course, PBGC is clearly not on the brink of insolvency. Using the reserves may, in fact, be in the long-term interest of pension plan participants and program survival.

Congress must consider whether PBGC might get into severe financial trouble if there is a delay in the premium increase. Worst case studies have been done that can assist in that analysis. A

study published in the spring of 1982 presented the worst case for PBGC. This was reaffirmed by PBGC in its own testimony in that year, noting that the maximum potential claims projected for PBGC, in their view of the worst potential terminations, would equal \$4.3 billion over the remaining lifetimes of the plan participants and beneficiaries. I would note that of that \$4.3 billion total, almost \$1 billion was attributable to the Chrysler Corp., which appears now to no longer be in this worst case category.

This means that most pension plans present no risk whatsoever to the PBGC at this time. Instead, they have accumulated over \$400 billion in assets—at a minimum—to assure that promised benefits will be paid.

What we know about the financing of the PBGC and the strength of the pension system appears to justify certain conclusions. PBGC will at some time in the future need more revenue than the current premium provides. Second, the current liability and the total liability are small compared to the total assets of the single employer defined benefit pension plan universe. And third, since liabilities occur in part due to the structure of the insurance program, the premium issue should not be explored in isolation.

A clear consensus seems to exist here in the United States, as well as in international capitals, that the program is in need of fundamental reform if it is to match the general approach to termination insurance. You have heard about that in some detail. The important point is this. The design of the program has itself created a portion of the current liabilities, not only through abusive situations but also through nonabusive situations.

Further, the present design can actually provide incentives for plan termination and disincentives for funding. Only plan participants will ultimately suffer if we continue a program design that stays in its current form. Mr. Tharp noted that with reform, the \$7 premium might hold for many, many years into the future. This would seem to be a clear argument for fundamental reform of the program and for the premium to be considered in the context of reform, since his written statement makes it clear that without reform the \$7 cannot be expected to hold into the future.

The PBGC's record of success should be built upon with certainty. Adjustments to the program, including premium changes, should be evaluated against the clearly stated purposes of ERISA and our principal purpose of assuring that pension beneficiaries will continue to get their payments in the future.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF DALLAS L. SALISBURY,* PRESIDENT, EMPLOYEE BENEFIT RESEARCH INSTITUTE

INTRODUCTION

Mr. Chairman, it is a pleasure to appear before you today to discuss the Pension Benefit Guaranty Corporation (PBGC).

* The views expressed herein are those of the witness and do not represent the views of Trustees, Sponsors or Staff of the Employee Benefit Research Institute. EBRI is a nonprofit, nonpartisan public policy research organization located in Washington, D.C.

I am President of the Employee Benefit Research Institute (EBRI), a nonprofit, nonpartisan public policy research organization founded in 1978. EBRI sponsors research and educational programs to provide a sound basis for legislative and regulatory policy decisions in the field of employee benefits. EBRI does not take pro or con positions on legislative proposals.

Prior to joining EBRI, I had the honor of serving at PBGC as Assistant Executive Director for Policy. During my tenure, I directed the congressionally mandated study of the Multiemployer Plan Termination Program that led to enactment of the Multiemployer Pension Plan Amendments of 1980.

Upon establishing EBRI in 1978, our very first project was to conduct a policy forum titled "Pension Plan Termination Insurance: Does The Foreign Experience Have Relevance for the United States?"¹ Experts from Germany, Finland, Sweden, Japan, and the United States came together to discuss a number of the issues reviewed by your Committee today—premium levels and calculations methods (fixed versus variable rate) and basic design questions such as alternative definitions of the "insurable" event.

That policy forum reinforced my conviction that pension policy must be considered in a more comprehensive manner than this nation has generally attempted. Further, it highlighted the fact that every aspect of a benefit guarantee program is interrelated: the premium structure, the program structure, and the nature of the guarantee. And, that other issues such as the reversion of assets are inextricably intertwined as well.

My statement today focuses on these interrelated issues. First, I emphasize my concern that one of the most important purposes of the PBGC established by the 1974 Employee Retirement Income Security Act (ERISA) is not being given the full attention it deserves: continuation of pension plans.

Second, I seek to provide you with a framework for evaluating the PBGC request for a \$7.00 per participant premium for the single employer program.

Third, I seek to provide a framework for assessing whether the premium issue can appropriately be severed from the far-reaching issue of basic reform of the guarantee program.

THE PURPOSES OF PBGC

The first PBGC annual report was dated June 30, 1975, less than one full year after establishment of the program.² The transmittal letter stated:

"Enactment of the plan termination insurance as part of ERISA ushered in a new era in security for pension plan participants in the private sector. Approximately 29 million Americans covered by defined benefit plans are now assured that once their basic benefits become vested, those benefits are guaranteed."

The report also noted that the purposes of PBGC contained in ERISA are to: Encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants; maintain insurance premiums at the lowest level consistent with carrying out its obligations; and provide for the timely and uninterrupted payment of pension benefits under plans covered by PBGC.

The purposes intertwine to a greater degree than legislative policy debates of the last nine years have implied. The debate over the current request for a premium increase, for example, has failed to consider possible effects on the universe of pension plans. Plan continuation is the basis of funding the PBGC and of providing retirement income to the vast majority of present and future retirees.

The nine years preceding passage of ERISA saw the creation of over 177,000 defined benefit plans—a 321 percent increase (Table 1). The nine years following passage of ERISA saw the creation of just over 95,000 defined benefit plans—a 41 percent increase. Calendar year 1976 actually saw a net decrease in the number of defined benefit pension plans.

These data indicate that the scope and nature of federal regulation clearly affect employer decisions regarding sponsorship and design of defined benefit pension plans.

HAS PBGC ACHIEVED ITS PURPOSES?

First, as far as making benefit payments: PBGC has provided for the timely and uninterrupted payment of pension benefits under terminated plans. During FY 1983 32,600 beneficiaries received benefit checks from the two trust funds of the PBGC. The FY 1985 proposed budget estimated 61,800 beneficiaries for FY 1984 and 68,700

¹ Published in 1979 and still available from EBRI.

² Pension Benefit Guaranty Corporation, "Annual Report to the President and Congress, June 30, 1975 (U.S. Government Printing Office: Washington, D.C.).

in FY 1985. PBGC's most recent statement estimate 75,000 beneficiaries for FY 1984 and 90,000 for FY 1985.

Second, concerning premium levels: PBGC can be judged in more than one way relative to this purpose. Advocates of a pay-as-you-go system suggest that PBGC premium requests have been too high. Yet, advocates of a fully funded program suggest that PBGC premiums and requests haven't been high enough.

Third, in terms of encouraging defined benefit plans: the current program—and in that sense of PBGC—appear to neither encourage the maintenance nor the creation of defined benefit plans. From the earliest days of the PBGC—including the period during which I ran the policy staff—this has not been an explicit guide used as a touchstone in policy deliberations. Up to and including the debates of 1982 and 1983, preservation and expansion of the premium base—i.e., the universe of defined benefit plans—has not been given much consideration.

Terminations of major pension plans in recent years, and the significant post-ERISA slowdown in the establishment of new defined benefit programs, provide evidence that PBGC and the Congress should become explicitly concerned with this founding purpose. Yet, the March 1982 PBGC study entitled "Premium Requirements for the Single Employer Base Benefit Insurance Program" did not even mention this purpose, not even Section VI which assessed the "Impact of the Premium Increase." The General Accounting Office issued a report to the Congress on November 14, 1984 (GAO/HRD-84-5) entitled "Legislative Changes Needed to Financially Strengthen Single Employer Pension Plan Insurance Program." The GAO report also totally ignored this founding purpose of the PBGC. Finally, in Senate testimony supporting a proposed premium increase, the PBGC failed to even mention this purpose or assess the potential consequences on defined benefit plans—the premium base—of the proposed 169 percent premium increase.

If Congress hopes to maintain the PBGC as a self-financing agency, Congress must carefully consider the implications of every legislative pension policy decision for the "maintenance and creation of defined benefit pension plans." Not only do they provide the funds for the PBGC, but they also aid in meeting the economic security needs of millions of Americans at all income levels.

THE PBGC DEFICIT AND PREMIUMS

Although PBGC has sufficient financial reserves to cover its known obligations for the next several years, it does not have enough of a financial reserve today to pay all the future benefits it is responsible for as a result of terminations of plans with insufficient assets.

Of the more than 46,000 single employer defined benefit plans that have terminated since the enactment of ERISA, just under 1,000 had insufficient assets (2 percent). By the end of FY 1983 the PBGC estimated its deficit from these terminations at over \$400 million. The studies already mentioned argue that the deficit merits an immediate premium increase "to guarantee that our (PBGC) obligations will be met." And, PBGC argues that the premium increase "is essential to our (PBGC) existence as a sound insurance corporation and to guaranteeing payment of future pension benefits to some 40 million Americans."

The continuation of enough defined benefit pension plans to pay PBGC premiums is—in fact—the only way to guarantee PBGC solvency on a self-financing basis.

PBGC projects continuing deficit growth if the premium increase is not granted. This is based on an income estimate of \$127,596,000 at the present rate (\$2.60) compared to \$286,006,000 at the proposed rate (\$7.00).

PBGC projects FY 1985 expenses of \$237,650,000 as compared to FY 1984 estimate of \$192,327,000. This increase is due to project growth in benefit payments in FY 1985 to \$182 million from \$156 million in FY 1984. This means that, at the present premium rate, income would fall short of expenses by approximately \$110 million in FY 1985.

But PBGC estimates total reserves at the end of FY 1983 at \$1.1 billion, i.e., enough to cover the current annual revenue shortfall for several years.

While use of reserves for this purpose might not be the ideal policy course, PBGC is clearly not on the brink of insolvency; and, using the reserves may, in fact, be in the interest of program survival.

A review of the FY 1983, FY 1984 and FY 1985 budgets indicates why defined benefit plan sponsors are concerned about (1) the structure of the current program and (2) prospects for future premium rates.

The PBGC, for reasons I shall return to, is not an insurance program in any conventional sense of that term. This is reflected in its annual budgets. The budget shows that PBGC has let each current year serve as its guide to the future. In terms

of number of terminations the FY 1984 budget projections of 145, was based upon an actual 1982 experience of 155. The FY 1985 budget assumed trusteeship of 102 insufficient plans in 1984—the number it did acquire in 1983. The FY 1985 budget assumes the 102 plan rate for 1985 as well.

How did the budget projections prove out? Even through forty-three fewer insufficient plans terminated in 1983 than expected—a 30 percent error—PBGC's liabilities were only \$15 million lower than the earlier budget estimate based upon the higher termination rate—a 2 percent dollar reduction. In other words, the total deficit was only 3.6 percent less than projected in spite of this significant 30 percent drop in terminations.

This trend is consistent with PBGC budgets since FY 1976. The PBGC, given the non-insurance design of the program, has been very unsuccessful in projecting year to year experience. The PBGC liability at the end of FY 1982, for example, was \$585 million, or 52 percent higher than projected in the FY 1983 budget.

The sponsors of defined benefit pension plans who support the program financially have argued that a premium increase—or a change in the premium calculation method—should come about only as part of reforms that bring insurance principles to the program.

Congress must consider whether PBGC might get into trouble if there is delay in the premium increase. Worst case studies have been done that can assist in that analysis.

A study published in the spring of 1982 in the *New England Economic Review* presented the "worst case" for PBGC in identifying the eighty-six firms out of 6,000 firms that had unfunded liabilities exceeding 30 percent of net worth. Were all eighty-six to have terminated, they would have represented potential claims totaling \$4.3 billion over the remaining lifetimes of the plan participants and beneficiaries. All single employer defined benefit pension plans have current assets of more than \$400 billion—a very significant asset coverage ratio for the system which means that at its worst the potential exposure of PBGC is less than 1 percent of total pension asset reserves.

THE PBGC AND PENSION FUNDING

The early history of pension plans was marked by plan failures because many plans operated on a pay-as-you-go basis. The low contributions necessary in a plan's early years had caused some employers to overpromise. When pension contributions became very high in later years, the plan could not be financially maintained. Without advance funding a pension plan must continue for any benefits to be paid.

Prior to ERISA, sponsors were legally required to contribute only the "normal cost" plus interest on accrued liabilities. As a result, a major portion of contributions made on behalf of active workers were frequently being used to pay retiree benefits. For the most part, this is the pay-as-you-go funding approach used today for social security, civil service retirement, and military retirement.

ERISA established stricter funding requirements. The minimum ERISA contribution for a single employer defined benefit plan is the normal cost, plus forty-year funding of pre-ERISA past service costs, plus thirty-year funding of post-ERISA past service costs, plus fifteen-year funding of investment experience gains and losses, plus thirty-year funding of gains and losses resulting from changes in actuarial assumptions.

ERISA also established that past service costs could not be funded on a tax deductible basis on less than a ten-year basis. In this sense, ERISA discouraged full funding of plans. Nonetheless, the defined benefit pension plan universe is well funded.³

THE FUNDED STATUS OF PLANS: IS THERE A PROBLEM

Greenwich Research Associates (GRA) began doing an annual survey of large corporate pension plans in 1972 covering the vast majority of plan participants. Those surveys have traced the trend of increasingly better funding of the major pension plans in this country.

The overview essay to the GRA's recently released eleventh survey which covered 1,670 large corporations noted:

"... The aggregate unfunded past service obligations for large corporations are now less than 10 percent of total employee benefit fund assets. Unfunded obligations of

³ For a thorough treatment of this issue see "Retirement Income Opportunities in an Aging America: Pensions and the Economy," by Sophie M. Korczyk, Chapter II (Washington, DC: Employee Benefit Research Institute, 1982).

large corporations are estimated at \$29 billion while employee benefit fund assets are projected to be \$325 billion. The vested and unfunded obligations are estimated at only \$13 billion—less than 5 percent of total assets.”⁴

A recently released survey of 550 of the nation's largest corporations, conducted by Johnson & Higgins, one of the nation's leading employee benefit consulting firms, found that, in the aggregate, 92.5 percent of total accumulated benefits were fully funded and 95.4 percent of vested benefits were fully funded.⁵ Four-fifths of the surveyed companies were fully funded with respect to vested benefits; two-thirds of the surveyed companies were fully funded with respect to total accumulated benefits.

This means that most pension plans present no risk to the PBGC at this time. Instead, they have accumulated over \$400 billion in assets to assure that promised benefits will be paid.

What we know about the financing of PBGC and the strength of the pension system appears to justify certain conclusions:

First, PBGC will at some time need more revenue than the current premium of \$2.60 per year per participant, if insufficiently funded plan terminations continue;

Second, the PBGC's current liability, and the total liability exposure of the PBGC, are small compared to the total assets of single employer defined benefit pension plans; and

Third, since liabilities (the deficit) occur, in part, due to the structure of the program, the premium issue should not be explored in isolation.

THE PBGC DEFICIT, THE PREMIUM, AND REFORM

A clear consensus exists that the PBGC program is in need of fundamental design changes. The program violates the basic principles of insurance to such a degree that PBGC cannot hope to be “a sound insurance corporation”—as it claims it would be if a \$7.00 premium were granted—without reform.

First, the PBGC maximum liability is not predetermined and is based upon an unrelated condition—the plan sponsor's net worth;

Second, the insured can increase the insurance coverage (benefits) without the consent of the insurer (the PBGC); and

Third, the premium paid is unrelated to the amount of coverage obtained.

At the 1979 EBRI policy forum it was pointed out that:

“In the absence of an attempt to return to basic insurance principles (i.e., risk borne by related plan sponsors and their employers), the only solution can be excessive premiums (i.e., risk borne by unrelated plan sponsors) or application of general revenues (i.e., risk borne by the general taxpayer).”

A framework for reform was suggested by the participants at the EBRI forum. Reforms suggested at the forum would, first, be based upon movement toward principles of insurance. Second, PBGC would only take on obligations at the point that a plan sponsor terminating a plan experienced business insolvency. Third, a form of reorganization or temporary relief would be offered to plan sponsors who are in financial difficulty but are not insolvent. Fourth, premiums would somehow be tied to the exposure created for the PBGC.

Since 1979, the Administration, members of Congress, and others have suggested similar changes in the single employer program.

The important point is this: the design of the program has, itself, created a portion of the current liabilities. Further, the present design can actually provide incentives for plan termination and disincentives for funding. For example, an increase in the premium rate at this time would initially reduce the deficit, but could actually cause the financial situation to worsen over time, in the absence of program redesign that encourages the maintenance and establishment of defined benefit pension plans.

As I have reported, it does not appear that anyone in the federal government has undertaken this analysis. Yet, millions of middle-income workers could needlessly be put in jeopardy due to this failure to act in a careful and comprehensive way.

⁴ Large Corporate Pensions 1983 (Greenwich, Connecticut: Greenwich Research Associates, 1983), p. 1. The 1984 survey will be released in late March 1984.

⁵ Executive Report on Large Corporate Pension Plans 1983 (New York: Johnson & Higgins, 1983).

CONCLUSION

ERISA served to strengthen many of those pension plans that existed in 1974, and it assures that employers establishing new plans will carefully consider design and funding.

PBGC has already assured that tens of thousands of pension participants and beneficiaries will receive greater benefits than would have occurred had ERISA not been passed.

The PBGC's record of success should be carefully built upon. Adjustments to the PBGC program—including premium changes—should be evaluated against the purposes stated in ERISA. Other ERISA proposals, such as reversion of assets, must also be considered in terms of their PBGC implications. Any changes or "reforms" that might discourage the maintenance and growth of defined benefit pension plans may be inconsistent with the nation's long term economic security goals; and they may harm the PBGC. This long term perspective should—and must—become the basis of premium increase and program reform considerations.

Mr. Chairman, I would like to ask that the relevant sections of two ERBI publications that I cited in my testimony be made a part of the hearing record.

TABLE 1.—CORPORATE DEFINED BENEFIT PENSION PLAN QUALIFICATIONS, TERMINATIONS, AND NET PLANS CREATED, 1956–83

Year	Plans qualified	Plans terminated	Net plans created	Cumulative number created	Percent growth
1956.....	3,175	192	2,983	19,209	18.4
1957.....	3,527	180	3,347	22,556	17.4
1958.....	3,883	224	3,659	26,215	16.2
1959.....	3,824	270	3,554	29,769	13.6
1960.....	5,011	300	4,711	34,480	15.8
1961.....	4,919	374	4,545	39,025	13.2
1962.....	5,188	476	4,712	43,737	12.1
1963.....	5,840	441	5,399	49,136	12.3
1964.....	6,581	509	6,072	55,208	12.4
1965.....	7,495	512	6,983	62,191	12.6
1966.....	10,124	603	9,521	71,712	15.3
1967.....	11,292	602	10,690	82,402	14.9
1968.....	12,896	672	12,224	94,625	18.8
1969.....	14,692	868	13,824	108,450	14.6
1970.....	16,512	1,142	15,370	123,820	14.2
1971.....	22,493	1,605	20,888	144,708	16.9
1972.....	28,265	1,745	26,520	171,228	18.3
1973.....	33,830	2,222	31,608	202,836	18.5
1974.....	32,579	2,577	30,002	232,838	14.8
1975.....	15,319	4,550	10,769	243,607	4.6
1976.....	4,790	8,970	-4,180	239,427	1.7
1977.....	6,953	5,337	1,616	241,043	.7
1978.....	9,728	4,625	5,103	246,146	2.1
1979.....	15,755	3,267	12,488	258,634	5.1
1980.....	18,849	4,297	14,552	273,186	5.6
1981.....	23,789	4,536	19,253	292,439	7.0
1982.....	28,189	5,043	23,146	315,585	7.9
1983 ¹	18,393	5,481	12,912	328,497	4.1
Total: 1975–83.....	141,765	95,629	328,497	328,497	

¹ 9-month period, Jan. 1, 1983 to September 30, 1983.

Source: IRS Disclosure Data: EBRI tabulations.

Chairman RANGEL. Thank you very much.
Ms. Ferguson?

STATEMENT OF KAREN W. FERGUSON, DIRECTOR, PENSION
RIGHTS CENTER

Ms. FERGUSON. Mr. Chairman, Mr. Pickle, I am Karen Ferguson, director of the Pension Rights Center. The center is a nonprofit group organized 8 years ago to protect and promote the pension rights of workers and retirees.

The Pension Benefit Guaranty Corporation is asking you to approve legislation that would restructure the single employer pension insurance program. We ask you not to act on this legislation without first undertaking an in-depth examination of its long-term implications.

The situation today is all too reminiscent of the situation 4 years ago, when we appeared before the committee to testify on the proposed restructuring of the multiemployer pension insurance program. Then, as now, you were told that there was agreement among the IRS, the Labor Department, and the PBGC, and between management and labor. Then, as now, you were told that there would be catastrophic consequences if the legislation were not approved quickly.

In retrospect, it is fair to say that failure to change the multiemployer program would probably not have had the catastrophic results predicted. Certainly we know that much of the specter of imminent disaster was largely generated by groups motivated in part by nonpension considerations, and we know that the extremely complex legislation that resulted went well beyond the specific problems targeted and seriously jeopardized the future pension benefits of hundreds of thousands of workers.

The single employer pension legislation that has been proposed will not have as direct or as quantifiable an impact on participants' pension benefits. The Multiemployer Pension Plan Amendments Act specifically requires financially troubled pension plans to cut back on participants' pension benefits. No such cutbacks are contained in the proposed single employer insurance legislation.

In fact, with a few significant exceptions, the proposed legislation does a creditable job of protecting the short-term interests of participants. All but one of the gaps in protection can be filled with relatively modest modifications of the bill.

The problems with this bill are more subtle, more basic, and much more far reaching. In the long run, this bill may have even more of an adverse impact on participants than the Multiemployer Act.

If H.R. 3930 or a similar bill were adopted in its present form, it would ratify two PBGC policies that run squarely counter to the interests of participants and are inconsistent with what we perceive to be the intent of Congress in enacting ERISA.

We are convinced that these policies would not have been approved had they been considered in 1974. We do not think they should be approved now.

Simply stated, these policies are, first, that the PBGC should be administered as if it were a private, for profit insurance company rather than a Government pension protection agency, and second, that employers should be allowed to terminate sufficient plans at will even if they are not going out of business and even if the ter-

minations will be detrimental to the interests of workers and retirees.

Possibly the clearest statement of the PBGC's conception that its role should be that of an insurance company was its 1982 request for a \$6 premium in order to enable it to retire its deficit over a 5-year period.

That proposal has now been modified to a \$7 premium over 15 years, but the question that many of us asked in 1982 was, why should a Government agency, likely to be a permanent institution, be seeking the kind of funding appropriate to a fly-by-night private insurer that at any moment might close its doors, leaving policyholders stranded?

The notion advanced by a number of pension actuaries that it might be appropriate to fund the PBGC over a 20- or 30-year period, much as pension plans are funded, was categorically rejected by the PBGC.

The view of the PBGC as an insurance company rather than a pension protection agency is by no means universally held. It has been the subject of longstanding debate within the PBGC and within the pension community. Throughout most of its history, the insurance company approach has predominated. The most concrete and devastating to participants manifestation of this has been the agency's regulations which have denied participants benefits they thought they were entitled to receive under ERISA.

The PBGC has taken the position that seemingly clear legislative language is ambiguous and has construed it in favor of conserving costs. This philosophy pervades all aspects of the agency's operations. Recently it has been carried to such an extreme that there are no longer any participant representatives on the PBGC's advisory committee. Almost all of the seven members have insurance company connections.

The most disturbing of the substantive provisions of H.R. 3930 also reflects this insurance company orientation. It would remove from the PBGC a very important function, thus saving substantial amounts in administrative costs, but at the expense of potential loss of a great many benefits.

Under current law, a plan cannot be closed out until the PBGC has determined that it has sufficient funds to pay all vested benefits. The PBGC's scrutiny of a plan's allegation of sufficiency can be quite intense. In addition to ascertaining whether the assets claimed by the plan administrator are actually in the plan, the PBGC also contacts plan members to make sure that all persons entitled to benefits are accounted for in the statement of the plan's liabilities.

If the plan is found to be sufficient, the PBGC then monitors the allocation of assets. The law requires that if there are more than enough assets to pay vested benefits, people who are not yet vested must also receive benefits. It is an obvious temptation to an employer to overlook these people, particularly if the plan allows the employer to recapture excess assets.

Finally, the PBGC makes sure that the administrator buys annuities for their participants from a life insurance company. The PBGC is proposing in H.R. 3930 to give up these functions and rely instead on certification by an enrolled actuary that the assets are

sufficient. It proposes to count on the plan administrator's good will to be sure that the assets are properly allocated and annuities purchased.

If this proposal were to be adopted, a very substantial number of retirees would not receive the benefits they are entitled to under the law. Giving up these functions is consistent with the PBGC's conception of its role. An insurance company, after all, cannot reasonably be expected to concern itself with sufficient or overfunded plans. But if the PBGC does not retain this function, there will be no one to protect the participants in these plans.

H.R. 3930 would also allow plan administrators to terminate pension plans at will as long as the plan has sufficient assets to pay vested benefits. The plan can be frozen and then closed out for any reason, even if the only purpose is to meet short term corporate needs. It can be closed out regardless of the harm to participants. In other words, it specifically sanctions the practice now termed "raiding of assets."

The issue of termination for corporate purposes was not considered by Congress in 1974. It is now the subject of vigorous debate. There is a growing consensus that the practice is wrong and should be stopped. Contrary to the claims of employers seeking to terminate their plans, there is an immediate and direct harm both to the retirees and active workers in terminated plans.

At the heart of the controversy over this issue is the question of whether a decision Congress made in 1938 that pension trusts should be revocable should continue to be valid. There have been a great many changes since 1938. At that time there were relatively few pension plans. Those plans that existed were considered to be gratuities, similar to gold watches, given to long service loyal employees.

In that context, a decision in favor of revocability was not too surprising. There was also far less reliance on plans as an essential source of retirement income, and there was no inflation.

All of these factors may argue for a different decision in 1984.

In our opinion, these issues must be addressed before the concept of at-will terminations of sufficient plans is endorsed by adoption of any of the single employer legislative proposals.

Finally, let me just mention two major problems that have been cited by the PBGC in its request for a restructured program. The first is the need for additional income. The second is the need for a mechanism to prevent employers with low net worth from dumping their pension liabilities on the PBGC.

The GAO's recommendation for stricter funding standards for benefit improvements would go a long way to solving a major source of the PBGC's income problem. If Canada's plans can live with 15-year amortization for benefit improvements, U.S. plans should be able to accept this as well. Although stricter standards will not be greeted with enthusiasm by employers or unions, they may be an acceptable alternative to the prospect of three-fold increases in premiums every few years.

The dumping problem, as well as the recapture problem, can, we believe, be best addressed by imposing on the plan fiduciary a specific obligation—one we think is already present—not to proceed with closing out a plan unless he or she thinks a plan termination

is in the best interests of participants, or if the purpose of the trust is fulfilled, for example by a plant shutdown.

Since the result of dumping is invariably that benefits are, at best, frozen at current levels and, at worst, reduced to the guarantee levels, in all instances it is likely to be contrary to the participants' interests for an employer to terminate a plan solely for the purpose of dumping liabilities on the PBGC.

Thank you.

[The prepared statement follows:]

STATEMENT OF KAREN W. FERGUSON, DIRECTOR, PENSION RIGHTS CENTER

Mr. Chairman, Members of the Committee. I am Karen W. Ferguson, Director of the Pension Rights Center. The Center is a nonprofit group organized eight years ago to protect and promote the pension rights of workers and retirees.

The Pension Benefit Guaranty Corporation is asking you to approve legislation that would restructure the single employer pension insurance program. We ask you not to act on this legislation without first undertaking an in-depth examination of its long-term implications.

The situation today is all too reminiscent of the situation four years ago when we appeared before this Committee to testify on the proposed restructuring of the multiemployer pension insurance program. Then, as now, you were told that there was agreement among the Internal Revenue Service, the Labor Department and the Pension Benefit Guaranty Corporation, and between management and labor. Then, as now, you were told that there would be catastrophic consequences if the legislation were not approved quickly.

In retrospect, it's fair to say that failure to change the multiemployer program would probably not have had the catastrophic results predicted. Certainly, we know that much of the spectre of imminent disaster was largely generated by groups motivated in part by non-pension considerations. And we know that the extremely complex legislation that resulted went well beyond the specific problems targeted, and jeopardized the future pension benefits of hundreds of thousands of retirees.

The single employer pension legislation that has been proposed will not have as direct, or as quantifiable, an impact on participants' pension benefits. The Multiemployer Pension Plan Amendments Act of 1980 specifically requires financially troubled pension plans to cut back on participants' pension benefits. No such cutbacks are contained in the proposed single employer insurance legislation. In fact, with a few significant exceptions, the House Education and Labor Committee bill—we haven't yet seen the Senate Labor Subcommittee bill—does a creditable job of protecting the short-term interests of participants, and all but one of the gaps in protection can be filled with relatively modest modifications in the bill.

The problems with this bill are more subtle, more basic and much more far-reaching. In the long run, this bill may have even more of an adverse impact on participants than the Multiemployer Act.

If H.R. 3930 were adopted in its present form, it would ratify two PBGC policies that run squarely counter to the interests of participants and are inconsistent with what we perceive to be the intent of Congress in enacting ERISA. We are convinced that these policies would not have been approved had they been considered in 1974. We do not think they should be approved now.

Simply stated, these policies are:

- (1) that the PBGC should be administered as if it were a private for-profit insurance company, rather than a government pension protection agency, and
- (2) that employers should be allowed to terminate "sufficient" plans at will, even if they are not going out of business and even if the termination will be detrimental to the interests of workers and retirees.

I. RATIFICATION OF THE PBGC'S PERCEPTION OF ITSELF AS AN INSURANCE COMPANY

Possibly the clearest statement of the PBGC's conception that its role should be that of an insurance company was its 1982 request for a \$6 premium in order to enable it to retire its "deficit" over a five-year period. That proposal, reflected in H.R. 3930, has now been modified to a \$7 premium to retire the deficit over fifteen years. The question that many of us asked in 1982 was why should a government agency, likely to be a permanent institution, be seeking the kind of funding appropriate to a fly-by-night private insurer that at any moment might close its doors, leaving policy-holders stranded. It didn't make sense except as a reflection of the

then-Executive Director's deeply felt conviction that the PBGC was in fact no different from a private insurer.

The view of the PBGC as an insurance company rather than a pension protection agency is by no means universally held. It has been the subject of long-standing debate both within the PBGC and the pension community. Throughout most of its history the insurance company approach has predominated. The most concrete—and devastating to participants—manifestation of this has been the agency's regulations which have denied participants benefits they thought they were entitled to receive. The PBGC has taken the position that seemingly clear legislative language is ambiguous and has construed it in favor of conserving costs. This philosophy pervades all aspects of the agency's operations. Recently, it has been carried to such an extreme that there are no longer any participant representatives on the PBGC's Advisory Committee. Almost all seven members have insurance company connections.

The most disturbing of the substantive provisions of H.R. 3930 also reflects this insurance company orientation. It would relieve the PBGC of a very important function, thus saving substantial amounts in administrative costs, but at the expense of potential loss of a great many benefits.

Under current law a plan cannot be closed out until the PBGC has determined that it has sufficient funds to pay all vested benefits. The PBGC's scrutiny of a plan's allegation of sufficiency can be quite intense. In addition to ascertaining whether the assets claimed by the plan administrator are actually in the plan (rather than for example, merely being "accounts receivable" on the plan's books) the PBGC also contacts plan members to make sure that all persons entitled to benefits are included in the plan's liabilities. If the plan is found to be sufficient, the PBGC then monitors the allocation of assets. The law requires that if there are more than enough assets to pay vested benefits, people who are not yet vested must also receive benefits. It is an obvious temptation to an employer to overlook these people, particularly if the plan allows the employer to recapture excess assets. Finally, the PBGC makes sure that the administrator buys annuities for the participants from a life insurance company.

The PBGC is proposing in H.R. 3930 to give up these functions and rely instead on a certification by an enrolled actuary that the assets are sufficient. It proposes to count on the plan administrator's good will to be sure that the assets are properly allocated and annuities purchased. If this proposal were to be adopted, a very substantial number of retirees would not receive the benefits they are entitled to under the law. In some cases they would never know that they were entitled to benefits—they would not know that they had vested or that, as a nonvested participant in an overfunded plan, they were entitled to a pension—or they would discover only at retirement that no annuity had been bought for them or that the annuity that had been bought was valueless. At that late date there would be no effective recourse against the plan administrator or the enrolled actuary.

Giving up these functions is consistent with the PBGC's conception of its role. An insurance company, after all, cannot reasonably be expected to concern itself with sufficient or overfunded plans. But if the PBGC does not retain this function, there will be no one to protect the participants in these plans.

Before endorsing PBGC's perception of its role, we urge you to give full consideration as to whether this is sound public policy. We think it would be a very serious mistake.

II. TERMINATION OF SUFFICIENT PLANS AT WILL

H.R. 3930 would allow plan administrators to terminate pension plans at will, as long as the plan has sufficient assets to pay vested benefits. The plan can be frozen and then closed out for any reason, even if the only purpose is to meet short-term corporate needs. It can be closed out regardless of the harm to participants. In other words, it specifically sanctions the practice now termed "raiding" of assets.

During the past three years the IRS and PBGC have allowed more than \$1 billion to be recaptured by employers in this way, and they are about to approve the pending applications that will result in the recapture—and therefore loss to participants—of another \$1 billion.

This practice is being allowed because there is nothing, in the view of the agencies, that prohibits termination and recapture at will. There is no distinction in the law between terminations and recaptures that are consistent with the interests of participants or necessary, as in the case of a company shutdown, and others.

The issue of terminations for corporate purposes was not considered by Congress in 1974 and is now the subject of vigorous debate. There is a growing consensus that the practice is wrong and should be stopped. Contrary to the claims of the employ-

ers seeking to terminate their plans, there is immediate and direct harm both to the retirees and active workers in the terminated plans. The nature and extent of this harm is spelled out in the memorandum attached to this statement sent to the Assistant Secretary of the Treasury for Tax Policy on March 14, 1984.

At the heart of the controversy over this issue is the question of whether Congress' decision that pension trusts should be revocable in the Revenue Act of 1938 should be reconsidered. In 1938 this Committee reported out a bill that would have made pension trusts irrevocable. However, the Senate bill containing the current provision prevailed in Conference.

There have been a great many changes since 1938. At that time, there were relatively few pension plans. Those plans that existed were considered to be gratuities, similar to gold watches, given to long-service, loyal employees. In that context, a decision in favor of revocability was not too surprising. There was also far less reliance on plans as an essential source of retirement income and there was no inflation. All of these factors may argue for a different decision in 1984.

In our opinion all of these issues must be addressed before any single employer insurance legislation endorses the concept of at-will terminations of sufficient plans.

III. THE PROBLEMS RAISED BY THE PBGC CAN AND SHOULD BE ADDRESSED BY SPECIFICALLY TARGETED LEGISLATION

Two major problems have been cited by the PBGC in its request for a restructured program. The first is the need for additional income. The second is the need for a mechanism to prevent employers with low net worth from dumping their pension liabilities on the PBGC.

The GAO's recommendation for stricter funding standards for benefit improvements would go a long way to solving a major source of the PBGC's problem. If Canada's plans can live with 15-year amortization for benefit improvements, U.S. plans should also be able to accept this. Although stricter standards will not be greeted with enthusiasm by employers or unions, they may be an acceptable alternative to the prospect of three-fold increases in premiums every few years.

The dumping problem—as well as the recapture problem—can, we believe, be best addressed by imposing on the plan fiduciary a specific obligation (one we think is already present) not to proceed with closing out a plan unless he or she thinks a plan termination is in the best interests of participants (or if the purpose of the trust is fulfilled, by virtue of a plant shutdown).

Since the result of dumping is that benefits are, at best, frozen at current levels and, at worst, are reduced to the guarantee levels, in all instances it is likely to be contrary to the participants' interests for an employer to terminate a plan solely for the purpose of dumping liabilities on the PBGC.

PENSION RIGHTS CENTER,
Washington, D.C., March 14, 1984.

HON. JOHN E. CHAPOTON,
Assistant Secretary for Tax Policy,
Washington, D.C.

DEAR MR. CHAPOTON: The Cabinet Council is scheduled to meet tomorrow to determine Administration policy on pension plan asset reversions. This issue affects the retirement income security of millions of workers and retirees. Already more than a billion dollars has been withdrawn from defined benefit pension plans solely for the purpose of meeting short-term corporate needs. The workers who were covered by those plans will receive only a fraction of the amounts they had counted on for their retirement. The retirees in those plans have had their pensions permanently frozen at current levels, regardless of the impact of inflation on the real value of their benefits.

Although it is too late to protect the participants in these plans, it is not too late to protect countless others. We are writing to you with the hope that you will once again—as you have so consistently in pension policy debates in the past—take the lead in championing the interests of plan participants and beneficiaries.

The plans that have already terminated have been replaced by defined contribution pension plans, voluntary savings plans or, in some cases, no plans at all. The critical question at tomorrow's meeting is likely to be whether a second group of employers should be allowed to recapture another billion dollars in pension plan assets. These employers want to gain access to "surplus" plan assets by either replacing their current defined benefit plan with a new defined benefit plan or by a so-called "spinoff termination," where a defined benefit plan is split into plans, a retirees' plan that is terminated and an active workers' plan that is continued.

Advocates for the employers who stand to gain from defined benefit/defined benefit and spinoff termination arrangements have taken the position that participants will not be harmed by these terminations. They have argued that it would be a departure from long-standing Internal Revenue Service practice for these arrangements not to be approved and they have predicted that if these arrangements are not approved, employers will underfund their defined benefit plans. Their ultimate argument is that if the arrangements are not approved, employers wanting access to surplus assets will be compelled to replace their defined benefit plans with defined contribution or voluntary savings plans, or no plans at all.

In the enclosed memorandum we point out that, contrary to the representations of these reversion advocates, participants will be seriously and irreparably harmed if these arrangements are approved. We note that the advocates have produced no evidence to show that it was IRS practice (prior to the A&P termination) to approve terminations where the sole purpose was to gain access to plan assets. We suggest that their prediction that employers will underfund their plans, if not allowed to recapture assets at will, fails to take into account either "good actuarial practice" or the motivations of employers. Finally, we contend that the reversion advocates' ultimate argument, that employers not allowed to recapture assets for corporate purposes will terminate their defined benefit plans in favor of defined contributions plans (or no plans), demonstrates only that current rulings permitting defined benefit/defined contributions terminations should be reconsidered.

The paramount public policy goal in this area should be protection of the expectations of retirees and older workers. Principles of fundamental fairness require that once participants have lived up to their part of the pension bargain, the government should not allow their employers to "welsh on the deal." Technically, retirees and workers may only be entitled to what they have earned to date, but the reality is that they worked with the understanding that their plan would continue indefinitely and that to the extent monies were available in the future, they would receive benefit improvements.

These expectations can only be protected if the Administration adopts the position that plan terminations will not be approved where their sole purpose is to enable employers to recapture plan assets to meet corporate, as distinguished from participant, needs. Termination and recapture, of course, should continue to be allowed when the termination is incident to the shutting down of all or substantially all of an employer's operations. It should also be allowed when it is for the exclusive benefit of participants and beneficiaries. An example of a termination in the interests of participants would be where access to plan assets is the only hope for saving the employer and, therefore, jobs and full pension benefits.

The Internal Revenue Code and ERISA can readily be construed to provide the legal framework to put a stop to pension fund "raiding." The Code's exclusive benefit rule and ERISA's fiduciary standards make plain that a plan fiduciary cannot acquiesce in any action that is contrary to the interests of participants. Just as it is unlawful for a fiduciary to follow an employer's direction to make an imprudent loan, it is unlawful for a fiduciary to follow an employer's direction to terminate a plan (if termination is not in the interests of participants). The actual process of terminating a plan is a fiduciary's responsibility. He or she (not the employer) files notices with government agencies, does all of the work and makes all of the decisions necessary to close out the plan, and distributes the assets. If this fiduciary does not act, the termination process will not begin and the reversion provisions in the Code and Title IV of ERISA will not go into effect. As in the imprudent loan situation, the employer has the right to fire any fiduciary who refuses to follow the employer's direction, but any subsequent fiduciary would be under the same obligations to participants.

If, in your view, existing law is not sufficiently explicit on this point, clarifying legislation could be readily drafted. Such legislation could also give fiduciaries leeway, where recapture is appropriate, to adjust a plan's "liabilities" to take into account changes in the real value of retirees' pensions. Although Congress has not yet devised an across-the-board mechanism for mandating cost-of-living adjustments able to take into account the many variations in plans, fiduciaries should have little difficulty making such adjustments on an individual plan basis.

We look forward to learning the results of the Cabinet Council's deliberations.

Sincerely yours,

KAREN W. FERGUSON.
KAREN FRIEDMAN.

[Memorandum]

INTRODUCTION

In a letter dated December 19, 1983, and a memorandum dated December 20, 1983, lawyers representing employers seeking access to "surplus" pension plan assets urged the Treasury to approve "defined benefit/defined benefit" and "spin-off" termination arrangements. They contended that:

(1) Participants would not be harmed by these arrangements since annuities would be purchased for retirees from life insurance companies that would be equal to the amounts they are now receiving from their plans, and active workers would either continue under their current defined benefit plan (the "spinoff" arrangement) or would be covered by a new defined benefit plan (the "defined benefit/defined benefit" arrangement).

(2) Failure to approve these arrangements would represent a departure from long-standing IRS practice since terminations followed by reversions of assets have always been allowed. The December 19, 1983, letter cites congressional awareness of the Elgin Watch Company termination and reversion situation as evidence that this practice was sanctioned by ERISA.

(3) Approval of these arrangements is essential to the continued viability of the defined benefit pension system. Any policy penalizing spinoff or defined benefit/defined benefit terminations would "at best" cause employers to understand their plans and "at worst" would discourage them from establishing or maintaining defined benefit plans.

This memorandum addresses those arguments. It points out that plan participants would be seriously harmed by the proposed arrangements, that failure to approve the arrangements would not represent a departure from IRS practice and would not jeopardize the future of defined benefit plans.

I. PLAN PARTICIPANTS WOULD BE SERIOUSLY AND IRREPARABLY HARMED IF THE PROPOSED SPINOFF AND DEFINED BENEFIT/DEFINED BENEFIT ARRANGEMENTS ARE APPROVED

A. In both the spinoff and the defined benefit/defined benefit situations the monthly benefits retirees now receive from their pension plans would be replaced by annuities purchased from life insurance companies. The amounts paid under the annuity would be precisely the amounts the retirees are receiving from their plans. These amounts would remain unchanged throughout their lifetimes, regardless of how much the real value of their benefits is reduced by inflation. This is unrealistic. It is also unfair.

Although there is no legal requirement that retiree benefits be adjusted for inflation, many large plans have given ad hoc adjustments to retirees. According to a recently published study prepared for the Department of Labor by North Carolina State University, all of the plans surveyed with more than 10,000 retirees gave at least one increase during the period 1973-1979, and one fourth of these plans awarded an increase each year. Moreover, almost one fourth of all pensioners retired in 1973 received an increase in benefits every year, and approximately three fourths received at least one post-retirement benefit increase during this period.

In most cases the money to increase benefits for these retirees came at least in part from "surpluses" in their pension funds. Surpluses resulting from better-than-expected investment performance have traditionally been used to increase benefit levels for retirees (as well as for active workers). A frequently cited rule is that for every one percent increase in return on a plan's portfolio, the plan can pay out between 10 and 20 percent more in benefits.

A second Labor Department study (released at the same time as the North Carolina State study) shows that even if all of the portfolio gains earned by pension plans between 1970 and 1979 had been applied to cost-of-living adjustments for retirees, these amounts would not have been sufficient to pay the benefit increases actually received by retirees during this period. The study by Joel Popkin and Company states that the rate of return on pension fund portfolios would have allowed plans to increase benefits for retirees by only 8 percent, whereas retiree benefits were increased approximately three times that amount (24 percent during the period 1973-1979). The study concludes that inflation-generated surpluses, while contributing substantially to the retirees' benefit increases, were not sufficient. Substantial employer contributions were also needed.

The surpluses that have helped make cost-of-living adjustments for retirees "an easy thing to do" in the past would disappear if they are allowed to be "recaptured" by employers. In addition, although employers would be free to provide adjustments out of corporate earnings, once a life insurance company has sole responsibility for paying retiree benefits such adjustments are most unlikely. The natural psychological pressure that now encourages plan administrators (who see the erosion of the real value of retiree benefits on a monthly basis) to recommend benefit increases would simply disappear.

Retirees are, moreover, well aware of the connection between plan surpluses and future cost-of-living adjustments. Retirees groups have increasingly relied on the growth of plan assets in urging former employers to increase their benefits. In addition, retirees often make retirement benefit decisions based on knowledge that their plan is well-funded (and has given benefit increases to retirees in the past). From their perspective, arrangements that would remove all possibility of future increases after an individual has retired would be unconscionable.

B. Active workers would also be hurt by the proposed spinoff and defined benefit/defined benefit arrangements. In both types of situations the plans for active workers would include only the assets necessary to provide already promised benefits. Any funding "cushion" would merely be sufficient to assure that the plan would be able to pay accrued and already projected benefits. The absence of any surplus above this "cushion" would mean that workers are less likely to receive increases in benefit levels. There would also be no incentive to improve the plan to provide benefits to more people. If, as is likely, plan improvements are mandated by law, they would necessitate increased employer contributions at the expense of wages or other fringe benefits.

In the case of a defined benefit/defined benefit arrangement, the impact on workers could be far more severe. The employer would have the right to freeze the plan at current benefit levels and put the workers under an entirely new plan. The worker receiving a frozen benefit from the old plan plus a separate benefit based only on future service from the new plan would receive substantially less than if the old plan had remained in effect. There is also the possibility that the worker could lose the right to provide survivors benefits and to receive special early retirement benefits based on service under the old plan.

Although it is probable that the employers now seeking government approval for defined benefit/defined benefit arrangements will give their workers the same benefits they would have received had the old plan remained in effect, there is no requirement that they do so. Once public scrutiny of these new arrangements diminishes, other employers may adopt the practice now increasingly common in merger and acquisition situations where the changes in ownership have provided a "window of opportunity" for successor employers to freeze pre-existing plans and start new plans. Workers receive much smaller benefits under the two plans than if their old plan had remained in effect.

II. FAILURE TO APPROVE SPOFF AND DEFINED BENEFIT/DEFINED BENEFIT ARRANGEMENTS WOULD NOT REPRESENT A DEPARTURE FROM LONGSTANDING IRS PRACTICE

While the IRS has consistently allowed plans to terminate and recapture surplus assets, it has typically done so only in situations where the termination and recapture were incident to an employer shutting down all or substantially all of its operations. Certainly, this was the situation in the Elgin Watch Company case cited in the December 19, 1983, letter. Elgin was not terminating its plan solely for recapture purposes. Had it been doing so, Congress would have taken a very different view of the situation.

The lawyers representing the employers seeking approval of the new arrangements have pointed to no situations prior to the A&P termination where the termination was sought for the exclusive benefit of the employer rather than the plan participants. If, in fact, there were no such instances, IRS practice argues against rather than for further approval of these terminations.

III. EMPLOYERS WILL NOT BE DETERRED FROM ADEQUATELY FUNDING, OR MAINTAINING OR ESTABLISHING DEFINED BENEFIT PLANS IF SPOFF AND DEFINED BENEFIT/DEFINED BENEFIT TERMINATIONS ARE NOT ALLOWED

A. Most large plans use the "entry age normal" method of funding. This level funding approach is considered to be "good practice." It is doubtful that any enrolled actuary would recommend a "unit credit" method of funding for large well-established plans such as those now seeking to recapture funds.

Even if their actuaries would allow them to use a different funding method, the employers would be unlikely to do so. They typically need the tax advantages provided by a level funding method, as well as the personal retirement income security afforded by this method. With the Pension Benefit Guaranty Corporation insuring less than one-fifth of many executives' pensions, few companies are likely to want to run even the remote risk of becoming underfunded after their officers retire.

If employers actually did start to use less protective funding methods, it might then be appropriate for the IRS or Congress to prescribe presumptively valid funding techniques. Thus, level funding could be the presumed standard for all plans, with other methods for special situations (e.g., unit credit for the small, new company with excellent prospects for future earnings).

B. The argument that employers will not establish defined benefit plans unless they have the assurance that they can terminate them, recapture surplus assets and then start a new (or continue an old) defined benefit plan is without any foundation whatsoever. Hundreds of thousands of defined benefit plans have been set up by employers on the assumption that they would be permanent arrangements, lasting as long as the employer remained in business. None of these employers set up their plans in anticipation of eventual recapture of surplus assets.

Moreover, there is a serious question, independent of the recapture issue, whether many "legitimate" defined benefit plans will be set up in the future. Virtually all larger employers already have plans and what evidence there is on smaller employers (including the protests of small plan consultants at the enactment of the vesting and minimum benefit provisions of TEFRA) suggests that most of the defined benefit plans now being established are primarily structured as tax shelters for company officers rather than retirement income arrangements for the rank and file employees most in need of a supplement to social security. Rather than worrying about whether employers will set up new defined benefit plans, the critical policy issue is how to preserve the defined benefit plans we now have.

C. Advocates of spinoff and defined benefit/defined benefit arrangements contend that if employers are not allowed to gain access to plan assets in this manner they will be compelled to terminate their defined benefit plans in favor of defined contribution plans. This may or may not be true. A company president whose defined benefit plan is based on a final pay, integrated, backloaded formula would lose a substantial portion of his or her pension if the plan were terminated in favor of a defined contribution plan. But assuming that such terminations would result, that is less an argument in favor of the proposed approaches than an argument against defined benefit/defined contribution arrangements.

All these arrangements adversely affect participants. In terms of their impact on retirees, there are no differences between the approaches. All are equally disastrous. With respect to active workers, there are only differences in degree.

Arguably, the active worker left with no plan at all is slightly worse off than the worker who is allowed to join a voluntary savings plan—unless, as is probable, he or she can't afford to join the plan. The person with only a voluntary savings plan is considerably worse off than the person who is covered by a noncontributory defined contribution plan. But whether the person covered by a defined contribution plan is worse off than a person covered by an entirely new defined benefit plan is not at all clear. It will depend on a number of factors, including the age of the worker, length of service and plan provisions.

What is clear is that older, longer service workers and retirees, those individuals with the least opportunity to find other sources of income, would be considerably better off if their plans did not terminate at all. Protecting their interests should be the guiding principle for pension policy in this area.

D. Finally, implicit in the letter and memorandum, as in all discussions of the recapture issue, is the contention that "after all, the private pension system is a voluntary system." To be sure the private pension system is a voluntary system precisely in the manner that the U.S. Army is a voluntary system. If at any point the incentives provided by the system (in the case of pensions, these are tax, personal retirement income and capital formation incentives) are found to be insufficient, there will inevitably be a "draft." The nation can no more afford to be without a pension system than an army.

Mr. GIBBONS [presiding]. Thank you all.

Mr. Anthony.

Mr. ANTHONY. The question I have concerns the abuses, either real or perceived versus the premium increase request. Which, do you believe is the worst of the two?

Ms. FERGUSON. It seems to me, just looking at the GAO report, that they stated that there is no real short-term crunch for the PBGC. It would seem that a principal source of the problem was the fact that, as Mr. Gibbons said, there is no discipline in the defined benefit world.

Employers can give increases in defined benefits and provide that those benefits go back for all the years that somebody worked for a company. There are figures in the GAO report of \$20 million or more, \$40 million, in increased liabilities solely as a result of one benefit increase.

It may well be—and Dallas knows the statistics—that some increase in the premium is appropriate at this time. But I think that the problem here is that we are not willing to face some of the bitter medicine, the kind of discipline, of requiring faster funding of benefit increases.

The other point is that I am troubled by the fact that so much of the PBGC's so-called deficit comes from pre-ERISA liabilities. Those are not going to recur. Is it right to be generating this kind of scare concept on the basis of a so-called deficit that is a thing of the past? The PBGC is not going to shut its doors tomorrow. We do not have to think in those terms.

But those are just questions. A simple—well, not simple politically, but simple conceptually—reform such as faster funding is certainly a route to go. Then we can see what the impact on the need for premium increases would be.

Mr. ANTHONY. You do not disagree with the premise, then, that there needs to be an increase in the premium?

Ms. FERGUSON. I honestly do not know. I struggled through those figures, but I am not a statistician. I do not know. I defer to Dallas on that.

Mr. SALISBURY. Mr. Anthony, Mr. Gibbons made an eloquent statement as to one of the fundamental problems in the design of the current program. Under the current design of the program, those who have acted responsibly and who have been judicious in the funding of their programs basically pay the price of those who have not acted in said fashion.

At this point in time, if you raised the premium without making some fundamental design changes in the program, you would simply exacerbate the situation that Mr. Gibbons is referring to. For the responsible plan sponsor now with a pension plan, or the responsible business person who is thinking of establishing a plan in an effort to provide for the future retirement income security of the workers, here is basically what they are being asked to do, if only a premium increase without redesign is put into place: namely, to continue into the foreseeable future to subsidize the bad business judgments or the abusive business judgments of others who are not acting as responsibly.

As the numbers in my written testimony clearly indicate, we are talking about 85 to 90 percent of plans that are so thoroughly funded that it is inconceivable that they will ever provide any risk to the PBGC, supporting a relatively small number of plans that do provide risk. The PBGC's own testimony and the General Accounting Office study clearly indicate that PBGC, even if terminations were at \$180 million a year, could likely make it without difficulty

through the remainder of this decade. In this context, is it not reasonable to say that the Congress should spend 6 months, 12 months, or 18 months to deal comprehensively with this issue, rather than to respond to a momentary perception of a financial crisis?

Mr. ANTHONY. What is your conception of comprehensive congressional action over the next 18 months? What would you have this committee do?

Mr. SALISBURY. Come up with a comprehensive bill that deals with fundamental reform of the PBGC program. You have had recommendations in testimony already, and will have more in the remainder of the day. You have bills before the House and the Senate.

Mr. ANTHONY. Are you saying, shelve H.R. 3930 and start from scratch based on the record?

Mr. SALISBURY. No. I think you have two bills that this committee can use as a working basis for that purpose. But for many months now there has been a sense, not particularly well founded, that things have not been able to move because of multiple jurisdictions in this area, because of a continuing competition, that is between the tax and the labor committees.

I think that motion is probably ill founded. But in order to avoid that type of situation, this committee will have to move forward with the others to come up with a comprehensive reform.

Mr. ANTHONY. So you are saying correct the abuses and make the reforms, then start talking about premium increases. You agree with Mr. Gibbons?

Mr. SALISBURY. Without question, yes.

Mr. ANTHONY. Ms. Ferguson, do you disagree?

Ms. FERGUSON. It depends upon what the particular reform proposals are. I am worried about the particular proposals that have been advanced.

Mr. ANTHONY. You would like to make some serious policy changes from what current law is, I think.

Ms. FERGUSON. Of the two issues that I raised, the first is I think it is tremendously important to deal directly with. The question of what the PBGC's role is. Is it supposed to act in the future as a private insurer, always concerned about costs, never acting as a worker protection agency, never construing a statute, let us say, in favor of participants?

Is that appropriate for a quasi-government agency or whatever we are going to call it? I think that issue must be addressed or we are going to keep having situations such as this.

I talked with Dallas a little bit beforehand about the so-called billion dollars in assets. Well, that includes a lot of income from prior years, a lot of investment income, a lot of premium income. The way the PBGC presents the invasion of the assets that it says is going to have to occur if the premium increase is not allowed sounds very scary, until you realize that realistically that money has been built up. It is just premiums from prior years, it is just investment income, as well as basic assets.

My suggestion is that an agency that viewed itself as a pension protection agency, a Government agency, might present those statistics differently. It is a whole mental set that goes on in that in-

stitution, and we find it a matter of great concern at all levels. I think it has to be addressed by Congress.

The second point, the point of recapture, is an obvious one. If H.R. 3930 goes through as written, it is *carte blanche*. No more ambiguity. You may terminate your plan at will for whatever reason, as long as you can pay vested benefits. Retirees and workers are being hurt and they will be hurt to a much greater extent if this is allowed to continue.

That issue must be addressed before that provision is enacted.

Mr. ANTHONY. Thank you very much.

I yield back.

Mr. GIBBONS. I am not really familiar with H.R. 3930. You say it allows the dumping of a plan just at will?

Ms. FERGUSON. No. It does two things. It prevents a plan that does not have sufficient assets from dumping the liabilities on the PBGC. That is an important reform.

But there is almost a tradeoff for that. As a tradeoff for saying to employers you may no longer, if your net worth is very low, dump your liabilities on the PBGC and go off scot-free, we are going to allow you, if your plan is sufficiently funded or overfunded, to terminate that plan at will.

You have a going company, a profitable company. We have been hearing about them now quite a bit in the news. They terminate the plan. All benefits are frozen forever for those workers and retirees. A new plan may or may not be started, but for the retirees, they are lost no matter what.

That practice which is being discussed in the media and within the Congress is directly relevant to this bill. This bill ratifies that practice.

Mr. SALISBURY. If I might, Mr. Gibbons, it ties into one of the broader points I am attempting to make in my testimony, which is that there are a number of multifaceted provisions here that interrelate. One, which Karen has referred to, is the funding provisions of the Internal Revenue Code in this country as compared to another country's.

Under the Canadian system, there are 15-year funding standards, but there is an annual test of the ability for an employer, without terminating the plan, to recover some excess assets and to keep the plan going, in the same way, however, if there is a shortfall, the employer may have to put more money in. There is, therefore, the ability for a company in Canada to continue the pension plan and make the most efficient uses—as they would interpret them—of the assets that have been accumulated in the past, the contributions of the past.

Under the law as it is currently written in the United States, there basically is no choice. If an employer wants to recover those excess assets, the employer must terminate the plan in order to do so.

Now, whatever direction you choose, whether it is to say that an employer cannot ever terminate a pension plan; or whether you require the employer to take those excess assets and pay them to the Treasury in an excise tax; or you require payment to the PBGC; or you require payment to the current plan participations; or you adopt the Canadian example—the point is that there is a far more

complex set of issues here than merely a question of whether a premium should be increased.

Mr. GIBBONS. Well, I agree with that latter statement, that it is far more complex than that, and that is the reason why I am not for any premium increase until I see what changes have been made and see that there is some kind of consensus among those who deal with these things all the time as to whether or not the changes are proper.

Are plans being dumped now that have excess assets in them just to get at the excess assets?

Ms. FERGUSON. Yes, Mr. Gibbons. Already a billion dollars in assets has been recovered or recaptured. "Recapture" is a misnomer. They never had the assets in the first place.

The administration apparently has decided to allow another billion dollars in assets to be recovered. This is a very serious thing. It is a brandnew trend. It start with A&P about 3 years ago. It has been growing.

Mr. GIBBONS. It started with whom?

Ms. FERGUSON. A&P, the Atlantic & Pacific Tea Co. They terminated their plan and recaptured \$200 million in assets and then they started a new plan.

Mr. GIBBONS. Who received that? Who received the money out of that?

Ms. FERGUSON. Actually, the new owner, I think. Wasn't there a German owner who had bought the company? There was a letter to the editor in Fortune magazine which suggested that he probably got more from the surplus assets than he paid for the company, but I do not know if that is true.

Mr. GIBBONS. Well, the company was not worth much. I hope its pension plan was.

Ms. FERGUSON. Apparently it was.

Mr. GIBBONS. They are the only people in the grocery business who stayed in the grocery business as long as they did and never learned how to run a store. [Laughter.]

Mr. SALISBURY. Mr. Gibbons, if I may add one comment. It is not simply that employers are choosing to terminate their plans just to get at the excess assets. As a result of: one, changes proposed in the termination insurance program; two, changes proposed by the Financial Accounting Standards Board to place pension assets and liabilities on corporate balance sheets; and three, many congressional actions in the last 8 years that make a defined contribution plan a more "viable option" in terms of the amount that can be contributed, companies are reevaluating, both from the financial perspective and from the human resources perspective, what it is most desirable for them to do as a matter of corporate policy. Given the state of uncertainty in Government policy, there are many employees who are determined that they are best off to, while they still have options available to them of various sorts, to make shifts from defined benefit to defined contribution plan, or some other change.

I think Karen is very correct in saying that there have been some who have been solely motivated by the desire to get their hands on the money. But I think it would be unfair to say that that is what has motivated all of these employers in this situation.

Ms. FERGUSON. Just so the record is clear, the billion dollars in assets that is about to be recaptured as a result of the administration's very recent--this week's--decision to allow this to happen, these are all defined benefit plans that are terminating and setting up new defined benefit plans.

Or they are involved in what is called a spinoff arrangement, in which they simply, in effect, terminate the plan for the retirees—leaving the retirees fixed at their benefits forever, never having any cost-of-living adjustments, even though most big plans are giving cost-of-living adjustments—and continue the plan for the active workers.

There are a variety of arrangements. They are called DB/DB, defined benefit/defined benefit.

Mr. SALISBURY. It is one of the reasons, Mr. Gibbons, that I find it particularly troubling that the General Accounting Office and PBGC, in taking this strict financial balance sheet insurance company approach that Karen is referring to, have failed in all of their discussion of this issue to focus on one of the principal purposes set out for them in ERISA. That is, what does all of this mean for the existence of the plans that pay their premiums, and therefore what does it mean for the ultimate provision of retirement income to plan participants.

That kind of evaluation, as readily as the balance sheet evaluation, should be forced upon these agencies as a mandate, if you will, rather than simply very narrowly focusing on the cost issue without the balancing consideration of benefits coming into play.

I think, as you well know from your intimate involvement in the social security debates of recent years, that a crucial component of the social security debate, justifiably so, is the question of the benefits to be provided, of income adequacy. Given certain social objectives, what should the cost of the program be? And I think here we have a case where that benefit side is too frequently forgotten.

Mr. GIBBONS. Well, I will admit that we did not pay enough attention to this when we put ERISA together. We were looking at the Studebaker case and a few horrible examples like that and figured there ought to be some kind of guarantee for workers who were caught in that ridiculous position, and that was what we were primarily concerned about.

I do not think we ever figured that we would be faced with—you know, we really had no police plans in mind for PBGC when we set it up. We were only going to pool the risk. And frankly, we did not ever debate or thoroughly understand what we were doing when we set it up. And now we are coming back, trying to make something out of something that we did not understand to begin with. So that always leads to trouble.

But, on defined benefit plans, I was under the impression that most defined benefit plans were not indexed for inflation or did not give any increases for inflation for retirees. Are you telling me they do?

Ms. FERGUSON. Well, a Labor Department study just came out a couple of weeks ago which pointed out that, although only 3 percent of participants are covered by automatic cost-of-living adjustments—and those are very small—a very substantial proportion of

large companies are, out of the goodness of their hearts, giving "ad hoc" adjustments.

The figures were really quite startling. They looked at plans with more than 10,000 retirees and found that all of them had given at least one increase, and I think a very substantial proportion have given an increase each year. So adjustments have been made.

And then in the smaller plans, although the figures were not as dramatic, there were still very, very encouraging signs that companies are recognizing that the real dollar value of retirees' benefits can be totally eroded by inflation. We talked to people who left the company 10 years ago who say that people now leaving the company with the same service, same relative salary or same position are getting six times as much. And these people have the same cost of living as the new retirees.

Fortunately, some employers are recognizing that. The trend toward spinning off retirees, freezing their plans, having them all have annuities bought from insurance companies so that the employer has no responsibility for them—which is the technique which is used in the recapture situation—is tremendously disturbing.

Mr. GIBBONS. Well, let me ask you. We cannot go back and change the rules for the people who have already lived part of their life, at least we should not go back and do that. But in the future should we not just try to discourage people from setting up these defined benefit plans? Are defined benefit plans not a thing of the past, rather than the wave of the future?

Ms. FERGUSON. Dallas and I will disagree on this. I would probably agree with you. I think there are very few what you could call legitimate defined benefit plans being set up. There are very few plans that are being set up to provide benefits to the rank and file.

The plans, the new defined benefit plans that one sees, are ones sold by small plan consultants and insurance companies to very small companies. They are designed within the limits of the law, because now we have TEFRA, to pay off only to the higher paid.

Chances are that for those employees—and I am talking about the rank and file employees, particularly the younger people—they are probably better off under a defined contribution plan. There usually is very low or no vesting in those plans, and everything is there in their accounts, and they earn interest.

On the other side, I think the chief policy objective for the Congress right now has to be to preserve defined benefit plans for older workers and for retirees. So you have kind of a mixed thing. On the one hand, you are saying, well, this may not make sense for new workers coming into the system, but we have to preserve the system and that is why the insurance program is so important. These people have worked their lifetimes in reliance on a system, and the rules should not be changed now.

So we are at—I think you may be right that we are at a transition point and that it may well be that when employers who really want to provide benefits for their employees are thinking of setting up plans, they may well be thinking in terms of defined contribution plans.

But I know Dallas disagrees 100 percent.

Mr. SALISBURY. I would disagree, Congressman——

Mr. GIBBONS. Let me hear your argument, because I sure agree with her. You are going to have to argue real hard.

Mr. SALISBURY. I do disagree with Karen, and I will give you an example and do the best that I can. Sears, Roebuck & Co., for many, many years did provide a defined benefit plan for its salaried, higher-paid workers, but only a defined contribution plan for its lower-paid workers. And as is the case in many defined contribution plans, all of the assets of that plan were invested in corporate equities.

In the early 1970's the stock market took a very, very significant plunge. And Sears, Roebuck & Co., basically found itself in a position where none of its rank and file workers could afford to retire. Suddenly, what had been a large asset pool in the defined contribution program was of no particular value to employees.

The company, at that point, had no choice but to establish a defined benefit program so that their older employees could retire, because they did have the defined benefit promise in the same way that civil service retirees or military retirees do. The defined benefit plan created that flexibility.

The change we are witnessing is that more than 60 percent of workers who are part of pension programs now have both defined benefit and defined contribution programs from their employers. And the defined benefit program is no longer viewed, as it was in the 1950's and 1960's as being everything. The defined benefit plan is now viewed as another layer of benefits on top of social security.

And then to the degree that the defined contribution program, on top of the defined benefit plan, can be used to provide even greater amounts of income for retirement, or for short-service workers in particular, or for others, there is a combined system that can be used advantageously.

But I think Karen would be the very first to say that if the Nation went tomorrow to primarily defined benefit plans, and the year 1990 rolls along and the stock market drops from 1,500 to 500 and nobody can afford to retire with their defined contribution account, that there is some social covenant that, either by increasing social security or by mandating that employers do something, the nation will assure that those people not move into old age in poverty.

So I guess I would argue that the defined benefit component is one of the best opportunities for long-term retirement income planning, in combination with social security. But there is a question as to the relative balances of how much you try to provide with the defined benefit plan today and how much you should complement it with the defined contribution program.

For long-service workers—and there will still be millions, even in a restructured economy, that remain with one employer for 25, 30, 35 years—they will get a definite value out of a defined benefit program. For a shorter service worker, there is clearly a higher payback from a defined contribution program. But we should not, if you will, throw out the older worker in trying to accommodate the very high labor turnover of those who are under 30.

So I think that we need to strive for a balanced system. It needs to be a balanced system, so that we are in a position to take care of

workers at all ages, regardless of their family status, regardless of how frequently or infrequently they change employment.

Mr. GIBBONS. Ms. Ferguson, what do you think?

Ms. FERGUSON. Well, I would certainly say there is no question that, from the point of view of the long service employee who gets a defined benefit, there is nothing more attractive. First of all, all of his past service is taken into account. His benefit is usually based on final pay. And, as Dallas said, the employer bears the risk of the investment loss. There is no question that it is desirable.

But I think, Mr. Gibbons, what you are saying is that we are paying a definite price. We are seeing in the insurance system, which is really designed to insure the profitability of corporations, which is a difficult thing to do, as we have discovered, that there are problems.

I mean, everybody loves defined benefits, if you get one, because they are terrific. And defined contributions of course do not do as well for the long service employee.

Mr. GIBBONS. But very few people really get defined benefits.

Ms. FERGUSON. Well, that is the problem. That is the critical problem of the system. In order to make the defined benefit system a fair and workable system, we are going to have to make sure that more people get benefits and get benefits that are adequate benefits, that are not integrated.

Mr. SALISBURY. Under the Carter administration, the President's Commission on Pension Policy did indicate that by the turn of the century between 65 and 70 percent of the households retiring at that point would be receiving private pension income to supplement other income. For comparison, in 1960 the percentage of all retirees that received social security was still quite small compared to the number in 1970. The elderly in 1984 are now almost all covered by social security. In the same way, the pension system really did not start to grow dramatically until the 1960's, and we are witnessing that same maturing process. But the percentages of total workers who are and will be receiving pension income are growing dramatically just based on the system that exists. And that is true across all income categories. More than 75 percent of those who actually participate and earn service credits in pension plans are earning less than \$20,000 per year. Less than 1 percent of those who are earning pension credits earn in excess of \$50,000 a year.

So the numbers have often been used in a relatively misleading fashion in the past, Congressman.

Mr. GIBBONS. Well, to get right back to business now, do you all support H.R. 3930?

Ms. FERGUSON. There are some important modifications which I alluded to in our testimony that would have to be made on technical grounds. The bill does very well for the participant who is represented by a strong union. It does not do very well for participants who are not union members or whose unions do not have the sophistication to monitor such things as the distress termination—is there a valid reason for the termination, is the company really going under?

The bill has the concept there of a termination trust. Well, if you do not have somebody to enforce this for you it is a meaningless concept.

I am very, very concerned—and it is interesting that the first administration bill is better in this respect than H.R. 3930—with what I mentioned in my testimony, which is the PBGC's pulling out of what we see is an essential function, which is when a plan is not underfunded, but is sufficient or overfunded. The PBGC is pulling out all of the activities it performs now to make sure that those people get the benefits that they are entitled to, and they are leaving nothing in its place.

I would suggest that any bill or any modification of H.R. 3930 retain the PBGC's authority to review the sufficiency of plans, to oversee the allocation of assets, and to make sure that insurance policies are bought from a reputable insurance company.

Mr. GIBBONS. Do you support H.R. 3930?

Mr. SALISBURY. The Employee Benefit Research Institute does not take positions on legislation, Mr. Gibbons.

Mr. GIBBONS. Well, that is a comfortable position to be in.

Well, I will terminate there, Mr. Chairman.

Chairman RANGEL. Well, we want to thank you, and especially you, Ms. Ferguson. We will focus on the objections that you have raised, and may be calling upon you to expand further in that area.

Could you tell me, Mr. Salisbury just for my own personal edification, why you do not take positions on legislation?

Mr. SALISBURY. Because EBRI is purely a research organization. We do not even go as far as the GAO in making legislative judgments.

Chairman RANGEL. You do not what?

Mr. SALISBURY. We do not take positions on specific bills because we are a research organization and not a lobbying organization.

Chairman RANGEL. OK. Thank you.

[EBRI submitted the following:]

PENSION PLAN TERMINATION INSURANCE: DOES THE FOREIGN EXPERIENCE HAVE RELEVANCE FOR THE UNITED STATES?

An EBRI Policy Forum, June 25, 1979

(Edited by: Kenneth W. Tolo, Ph. D., Associate Vice President, for Academic Affairs and Professor of Public Affairs, The University of Texas at Austin)

THE PENSION REINSURANCE PROGRAM IN THE UNITED STATES *

The enactment in 1974 of Title IV (pension plan termination insurance) of the Employee Retirement Income Security Act (ERISA) has had a greater impact on retirement income in the United States than any other event since the enactment of the federal Social Security Act in 1935.

HISTORY OF PENSION PROTECTION IN THE UNITED STATES

The first pension plan in the United States was established by New York City in 1859, covering its policemen. The first plan in industry was the American Express Company plan in 1875. Another significant year was 1905 when the Granite Cutters established the first trade union (multi-employer) plan. All these plans, as well as all other plans established before 1917, were funded on a pay-as-you-go basis. No reserves were established from contributions of the plan sponsors. If a plan sponsor became insolvent or terminated the plan, the pension payments generally stopped and all benefits were lost.

* Presentation given by George B. Swick, Chairman of EBRI's Research Committee. Assistance in the preparation of these remarks was given by David H. Gravitz, Consulting Actuary, Buck Consultants, Inc.

Some of the early plans required employee contributions, in which case these amounts were accumulated in employees' accounts. However, it took 58 years from the establishment of the first pension plan to the established on a funded basis for both the employees' and the employer's money was the Teachers' Retirement System of the City of New York, which began operating in 1917. In 1921, the first insured group annuity contract was issued by the Metropolitan Life Insurance Company of New York.

In 1935, the establishment of the federal Social Security system greatly expanded the idea of pension planning and created a floor of protection. Contributions were paid into the fund starting in 1937, although benefit payments did not begin until 1940. As a result, a fund was created from which benefits were paid. In the early days the fund and incoming contributions were sufficiently large to maintain the benefits on an actuarially sound basis. This, together with the fact that the official name of the Social Security Act is the "Federal Insurance and Contribution Act," has led most people erroneously to view Social Security as insured and actuarially sound, and to expect a relationship between their contributions and expected benefits similar to the relationship between premiums and proceeds from an insurance company.

By 1940, the private pension system in the United States covered more than 4 million persons (out of a total population slightly more than 130 million) receiving annual benefits of \$140 million. Pension reserves totaled \$2.4 billion in 1940, one-fifth of what they would be ten years later.

There were two major causes of expansion in the private pension system in the 1940s. Inflation and taxation during World War II stimulated the expansion of private pension plans in industry. More than 2-1/4 million additional workers became covered by plans by 1945. The other major factor encouraging the spread of private pensions stemmed from collective bargaining. After World War II, many unions wanted to include pensions and other welfare benefits in the labor negotiation process. In a landmark decision, the United States Supreme Court ruled in 1949 (*Inland Steel Co. v. National Labor Relations Board*) that employers were required to bargain on the issue of pensions. Also in 1949, the Steel Industry Fact-Finding Board held that the steel industry had an obligation to provide its workers with pensions and other welfare benefits to take care of temporary and permanent depreciation of human machinery. From 1950 on, the unions have been an important factor in the spread and direction of pension coverage in the United States.

By 1950, more than 10 million persons (out of a total population in excess of 150 million) were covered under private pension plans. Pension reserves approached \$12 billion and annual payments to beneficiaries totaled \$370 million. Annual contributions to these plans exceeded \$2 billion by 1950.

Concern had been expressed for many years by a growing number of observers as to how well private pension programs were functioning. While only a small percentage of pension plans had actually failed, a considerable number of workers did lose benefits even after many years of service. Vested rights for workers were far from universal, and the funding provisions for some plans were less than sound.

During the 1950s and 1960s, typical eligibility requirements for vesting for plans that had vesting were 15 years of service and attainment of ages 40 or 45, but in many cases the employee had to be laid off or lose his job through a plant closing to vest; employees who quit could not get a benefit unless they were eligible to retire. Many plans had no vesting before reaching retirement age. In short, from 1950 through 1974 employees had limited guarantees that their pensions would be paid if their plan terminated.

Some pension plans were insured. To the extent pensions were purchased from and guaranteed by an insurance company, they would be paid. Under trustee plans and certain insured plans, however, employees could look only to the funds already accumulated for payment of their pensions. The allocation of the available funds also could vary widely from plan to plan, depending on the rules of the plan and the Internal Revenue Service (IRS) regulations. Some employees would receive their entire pension, some would receive a portion of it, and some employees would receive nothing. Companies were not legally required to guarantee pensions. Occasionally a company would undertake to provide pensions payable to the extent the pension fund was insufficient, but this was a voluntary act, not required by law.

One large union took the position that funding was not important provided the employer were contractually liable to pay pensions to the extent the pension fund was unable to pay them. Another large union took the opposite approach. Its pension settlements did not require the employer to guarantee payments of pensions; however, the contributions were required to be actuarially determined and be at least equal to the normal cost plus 30-year amortization of the unfunded past serv-

ice cost. Other unions (e.g., in the craft trades, construction industry, and maritime industry) felt there was strength in numbers and had all employers contribute to a single pension plan. Under these multiemployer plans, covered employees could move from participating employer to participating employer without loss of pension credits. Conservative funding was not considered necessary because many employers were contributing.

The "Studebaker incident"

In 1963 an event occurred that brought to the forefront the question of pension security in the United States and led directly, 11 years later, to the passage of ERISA. In December of that year, Studebaker, a large automobile manufacturer, closed its main United States plant in South Bend, Indiana. Thousands of employees were put out of work and the pension plan was terminated. The plan had been negotiated with the United Auto Workers (UAW) and contained the 30-year funding requirement described above.

The Studebaker plan had been amended just two years before the plant was closed. The amendments increased the benefits substantially, including benefits for past service. There was insufficient time in two years to build up the assets needed to augment the new past service benefits, even though the funding of the plan was in accordance with the labor agreement. As a result, the assets in the pension fund were insufficient to meet the pension liabilities. Although there was enough money to pay the benefits to those workers already retired (including the benefits that had been increased two years earlier), there was little left for the current work force. Employees within a few years of retirement lost about 40 percent of their pension. Younger employees lost their entire pension.

There are two points of interest here. First, the loss of pension benefits occurred despite the fact that the Studebaker Company met its 30-year funding obligation to the plan. Second, scheduled contributions under the plan exceeded the minimum funding requirements to be prescribed 11 years later by law (ERISA).

In the opinion of many pension experts, the Studebaker closing was the single most significant factor leading, first, to the passage of ERISA and, second, to the inclusion of termination insurance in ERISA (Title IV).

CURRENT STATUS OF PENSION PROGRAMS IN THE UNITED STATES

Federal Government programs

The Social Security system in the United States provides a minimal level of retirement income. Benefits are provided free of tax, except that employee Social Security taxes are paid from after-tax income. The benefits are fully vested and fully portable, and form an important source of retirement income to all covered workers. The Social Security system benefits, however, do not provide an acceptable level of retirement income and, as a result, private pension programs cover approximately 45 million workers in the United States.

While the federal Social Security system was established as a separate and segregated trust fund, with reserve accumulations fully contemplated, its provisions, both by statute and practice, furnish retirement income solely through a redistribution of wealth using the federal tax laws to furnish the necessary funds. Thus, federal Social Security benefits are guaranteed by the power of the federal government to tax its citizens—what economists call "transfer payments." It is not surprising, then, that over the years since 1935 the Social Security system has become a conduit through which tax revenues are redistributed to the retired population without significant accumulation of reserves.

Federal governmental employees, both civilian and military, are covered under comparable "funding" arrangements—that is, an allocation of federal tax revenues without a significant accumulation of reserves.

Interestingly, the receipts and disbursements of both Social Security and the federal governmental employee plans are included in the federal budget.

There is no reinsurance protection for participants in these plans other than the taxing powers of the federal government.

State and municipal government programs

The United States consists of 50 states. Each state consists of small subdivisions of local governing bodies (counties, cities, towns, or villages), often collectively called municipalities or local governments. Each state and municipality has certain revenue raising powers, within the limits established by the particular state. An important aspect of our system is that the federal government has no control or authority over most taxes levied by the states on their citizens.

Employees of state and municipal governmental units may be covered by locally adopted governmental retirement systems either supplemental to or exclusive of coverage under the Social Security system. That is, state, county, and municipal governmental units participate in the Social Security system on a voluntary basis.

As in the case of federal government systems, state and municipal government programs are financed by local tax revenues. Some of these programs are well-founded, using sound actuarial principles, while others are handled as a direct "income transfer" redistribution of current tax revenues, without a significant accumulation of reserves.

Title IV of ERISA is specifically not applicable to these plans. As in the case of the federal programs, there is no reinsurance protection for participants in these plans beyond the ability of the local governmental units to tax their citizens.

Private sector programs

Private pension programs are established and financially supported by one of four types of arrangements: A single employer, unilaterally established; a single employer, established pursuant to a collectively bargained labor agreement; a group of employers acting as a multiple employer group, unilaterally established; or a board of trustees, acting as a multiemployer group, established pursuant to a series of collectively bargained labor agreements.

Private sector pension programs fall into one of two important categories. Under defined contribution plans, contribution rates are specified in dollars, percentage of compensation, or percentages of profits, and the available resources are then equitably assigned among individual participants. Under defined benefit plans, participants receive defined benefits in either specified dollar amounts or specified percentages of compensation, with the plan sponsors accepting responsibility for the financial resources.

Defined contribution plans.—Under defined contribution plans, benefits to participants are directly related to accumulated financial resources. Investment performance, good or bad, inures directly to the plan participants. No other financial resources are available, and Title IV of ERISA is not applicable.

It is of interest to note that, under defined contribution plans, the entire proceeds can be invested in securities of the plan sponsor. Indeed, the Congress of the United States has indicated, through tax legislation, that it enthusiastically supports Employee Stock Ownership Plans under which employees obtain an ownership position in their employer by means of a defined contribution plan. The Congress has also encouraged the establishment of defined contribution plans for self-employed individuals and those individuals whose employers do not provide a pension plan, again through tax legislation. The Congress has not provided any reinsurance program for such plans, however; the plan participant assumes the entire investment risk.

Defined benefit plans for single employers.—Under defined benefit plans, participants receive specified benefits upon satisfying specified age and service requirements. The important issue then becomes how the financial resources are to be provided by the plan sponsor or sponsors.

Prior to ERISA, the tax laws were used to encourage adequate funding and the accumulation of adequate reserves. The plan sponsors' financial contributions were tax deductible, provided that sound actuarial principles were followed and minimum contribution levels were met. Prior to ERISA, these plans could be terminated at any time. Most plans provided that, in the event of plan termination, the participants could look only to the available assets of the plan for fulfillment of their benefit entitlement. In certain situations, however, collectively bargained labor agreements specified that the plan sponsor would guarantee benefits, if not covered by available assets, to the extent of its available resources. In a bankruptcy situation, plan participants could expect little, if any, financial recourse beyond the assets of the plan itself.

Under ERISA, the minimum contribution levels were strengthened and a most significant reinsurance program was added in Title IV. In contrast to the situation with respect to defined contribution plans, severe restrictions were placed upon investment in securities of the plan sponsor even though the participants were, for the most part, rendered risk-free by Title IV of ERISA.

Multiple employer plans.—Multiple employer plans are, in general, an assembly of single employer plans for the purpose of joint administration. Each employer is essentially responsible for the financial security of its own employees, and Title IV of ERISA provides the same reinsurance security. These plans cover relatively few employees, and will not be the subject of further discussion.

Multiemployer plans.—While multiemployer plans present a difficult descriptive challenge, they do represent a major sector on the United States private pension

scene. For the most part, these plans are defined benefit pension plans. They are established through a series of collective bargaining labor agreements between a single labor union and a group of employers whose employees are represented by that labor union. Contributions to the multiemployer plan are set forth in the collective bargaining agreements. These plans are administered by, and have their benefits established by, a board of trustees consisting of equal numbers of union and management representatives.

Prior to ERISA, multiemployer plans were generally considered to be defined contribution plans in the sense that each participating employer had no obligation beyond the requirement that it meet the contributions required by the labor agreement. Since these plans provide specified benefits to participants, the Congress included multiemployer plans within Title IV of ERISA, so that, theoretically at least, the participants in multiemployer plans had the same reinsurance provisions as participants in single employer defined benefit plans. In actual fact, however, the effective date of the application of Title IV to multiemployer plans has been deferred three times, most recently until May 1, 1980.

A joint board of trustees tested the application of Title IV of ERISA to multiemployer plans, contending that such plans were, in fact, defined contribution plans and thus not subject to Title IV of ERISA. The federal Supreme Court affirmed (in the case of *Connolly v. PBGC*) that Title IV of ERISA does not apply to multiemployer plans, however, when and if coverage is allowed to become effective.

PENSION PROTECTION UNDER ERISA

The so-called "broken promise"—the failure of pension plans to pay the pensions that employees (rightly or wrongly) expected to receive—surfaced in 1964 and inexorably led to the passage of ERISA 10 years later. Congressional concerns about pensions and the philosophy behind ERISA is evident in the declaration of policy in the beginning of ERISA.

"It is hereby declared to be the policy of this Act to protect . . . the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of fiduciary conduct, . . . by improving the equitable character and the soundness of such plans by requiring them to vest the accrued benefits of employees with significant periods of service, to meet minimum standards of funding, and by requiring plan termination insurance."

Under ERISA, five principles were established on which pension security could theoretically rest: Disclosure of pertinent information to employees; fiduciary standards of conduct; minimum vesting requirements; minimum funding standards; and plan termination insurance.

The first principle, disclosure, requires plan sponsors to inform participants of their rights and obligations under the plan and to provide them with the necessary information to make proper, informed decisions. Fiduciary standards assure employees that they will be treated equitably and fairly and that the pension funds will be used solely for their benefit. Under most plans, ERISA's vesting standards guarantee an employee with at least 10 years of service that he will be entitled to a benefit starting at normal retirement age (usually 65), regardless of the age his employment terminates. This avoids some of the pre-ERISA horror stories regarding employees with 20 or 30 years of service who did not receive a pension because they left the company prior to retirement (voluntarily or otherwise) or the plan was terminated shortly before they would have been eligible to retire.

The rest of this paper will deal primarily with the remaining two principles—funding standards and plan termination insurance. The first three principles are designed to ensure that all employees who are eligible to pension entitlement actually become entitled to them. Funding standards and termination insurance are designed to ensure that those employees who are entitled to pensions actually receive them.

Legislation addressing all five principles was considered necessary because previous laws were deemed insufficient to provide the desired protection to employees. However, it should be noted that even before ERISA was passed, laws existed—at both the federal and state levels—regarding disclosure, fiduciary standards, vesting requirements, and minimum funding standards. The only new concept produced by ERISA was plan termination insurance, a concept that had never before been considered in the United States. It is not unexpected, therefore, that such hasty legislation has resulted in massive problems, both conceptual and practical.

The full realization of these problems is only now coming into focus, five years after ERISA became law, as major revisions are being proposed to the Congress by

the Pension Benefit Guaranty Corporation (PBGC), the agency created by Title IV of ERISA itself. As previously indicated, plan termination insurance is still not in effect for multiemployer pension plans.

PENSION FUNDING IN THE PRIVATE SECTOR

When all issues are reduced to basics, the single underlying element is funding—when, how, and by whom.

The very nature of pensions suggests pre-funding. Benefits are earned over an employee's working career and are paid out in retirement after the career ends. Properly, the liability must be recognized while the employee is working, since pensions are in the nature of deferred compensation. The early history of pensions is rife with the failure of pension plans that were administered on a pay-as-you-go basis. The low outlay in the early years enticed many employers into promising higher pensions. These employers, after a period of time, found their pension payments increasing at such a high rate that the plan could not be financially maintained.

A "funding method" is a budgeting process that provides an orderly accumulation of funds during a worker's employment to provide benefits when due—the accountant's concept of matching revenues and expenses. Ordinarily this does not create problems for a continuing plan. Pension costs, as a percentage of compensation, can be predicted for a plan within a relatively narrow range. Problems sometimes arise, however, when a company has overall financial problems, or in cases where the work force is declining.

Reasons for insufficient funding

Occasionally, due to these financial problems or for other reasons, a plan—voluntarily or involuntarily—terminates. When this happens, even in plans that have been in existence for many years, plan assets may not be sufficient to provide the vested benefits. Three circumstances that can lead to an insufficiency of plan assets are: depressed value of assets, early retirement, and past service.

Depressed value of assets.—As a result of the vagaries of the investment decisions, less assets may be available to provide benefits than anticipated.

Early retirement.—Many plans provide early retirement benefits that significantly exceed the actuarial equivalent of the normal retirement benefits. The actuary normally expects only a fraction of those workers eligible to retire early in any year to actually retire in that year. When plan termination is accomplished by the closing of the facility or other termination of employment, however, as it often is, the increased number of early retirements can add significantly to the plan's pension liability.

Past service.—Pension plans are periodically improved, often every three years in many collectively bargained plans. When pension improvements are made, they are often granted for all previous service, as well as for service after the date of change. This increase in benefits for past service creates an immediate increase in vested liabilities under the plan (for all employees who are then vested). However, the increased liability is funded over a long period of time. Therefore, if a plan (even a well-funded plan) terminates soon after a sizable benefit increase is granted, there are likely to be unfunded vested benefits. This is what happened in the Studebaker situation described earlier. In addition, the required liberalization of the vesting requirements under ERISA has substantially increased vested liabilities under many plans. (In a later section is discussed the phase-in rule in relation to this situation.)

Table 1-1 shows the percentage of the past service liability that has been funded at various elapsed times after the liability is established, depending on the past service funding period used. Ten-year funding is the shortest period that can be used to obtain a fully tax-deductible contribution. Thirty or forty years represent the minimum past service funding requirements under ERISA, whereas interest-only funding was the minimum past service requirement before ERISA. Using a 6 percent interest rate, the table shows that during the first 10 years, the liability is more than ten times better funded on the 10-year period than the 40-year period, and that it takes over 20 years on 30-year funding and about 30 years on 40-year funding to fund even half of the past service liability.

Minimum funding requirements

Before ERISA, the minimum required contributions were equal to the normal cost plus interest on the unfunded past service cost on a cumulative basis. As shown in Table 1-1, past service costs would not be amortized on an interest-only basis and, in this case, the continuation of a plan was an absolute necessity to ensure payments of benefits. In effect, contributions on behalf of younger workers were helping

to pay the past service benefits to pensioners. Under certain funding methods before ERISA, experience gains could be used as a direct offset against the next year's contributions.

TABLE 1-1.—LEVEL OF PAST SERVICE BENEFIT FUNDED OVER A PERIOD OF TIME

(Based on 6 percent interest rate)

	Funding period (years)				Interest only
	10	20	30	40	
Years elapsed:					
5.....	43	15	7	4	0
10.....	100	36	17	9	0
15.....	100	63	29	15	0
20.....	100	100	47	24	0
30.....	100	100	100	51	0
40.....	100	100	100	100	0

The funding requirements under ERISA increased the contributions required under many plans. Under ERISA, the minimum required contribution is equal to: Normal cost, plus 40-year funding of pre-ERISA past service costs, plus 30-year (40-year for multiemployer plans) funding of post-ERISA past service costs, plus 15-year (20-year for multiemployer plans) funding of experience gains and losses, plus 30-year funding of gains and losses resulting from changes in actuarial assumptions.

ERISA requires the enrolled actuary to maintain a funding standards account, to determine the required contributions, and to certify to the Internal Revenue Service (IRS) that the assumptions used are reasonable.

Each year the funding standards account is charged with the minimum required contributions to the plan and credited with the actual contribution made. If the charges exceed the credits, a funding deficiency exists and the plan becomes subject to additional taxes and penalties and is also required to report this occurrence to the PBGC as a reportable event. If the credits exceed the charges, the net credit balance is brought forward with interest. At any time, the net credit balance indicates approximately how much extra contributions over the minimum required payments have been paid to the plan since the plan became subject to ERISA funding requirements. If a plan has a credit balance, its contributions may be reduced below the minimum ERISA requirements by an amount up to the credit balance without creating a funding deficiency.

Under the Internal Revenue Code, as amended by ERISA, the maximum tax-deductible contribution is equal to the normal cost plus 10-year funding of the past service cost. Before ERISA, the maximum deductible contribution was the normal cost plus 10 percent of the past service base.¹

TERMINATION INSURANCE

Basic purposes

The extent to which accruing benefits are often not funded until many years after they have accrued or become vested in employees is illustrated vividly in Table 1-1. If the plan terminates at a time when significant unfunded liabilities exist, there will generally not be enough assets in the plan to provide the vested benefits when due. This situation may be made worse, as indicated earlier, if the termination occurs during depressed securities markets or if an unusually large number of early retirements occur.

Society, as represented by the Congress, has determined that the loss of these pension benefits should not be borne, solely by the employees involved, as has been the case in the past, and that it is the duty of the federal government to provide these benefits from funds to which all covered pension plans contribute. The federal agency which administers this program is called the Pension Benefit Guaranty Corporation (PBGC).

¹ Ten percent of the past service base is about 16-year funding on 6 percent interest. Ten-year funding of the past service cost on 6 percent interest is about 13.6 percent of the base.

If this were the complete issue, termination insurance would be a relatively simple concept. However, there would be nothing to prevent an employer from establishing a high level of vested benefits in a plan, terminating the plan, and walking away from his responsibility, with the PBGC and, therefore, the economy in general "holding the bag." In its attempt to inhibit such conduct, the Congress created the fundamental issue that complicates Title IV—employer liability. Employer liability gives the PBGC the right to recover from the employer up to 30 percent of the employer's net worth to offset, in part, the cost of benefits paid by the PBGC as a result of the plan termination. The United States Court of Appeals (in *Nachman v. PBGC and UAW*) upheld the right of ERISA to subject employers to liability for the payment of vested benefits. A separate District Court decision (*PBGC v. Ouimet Corporations and others*) held that employers under common control may be held liable for the employer liability under a pension plan of a bankrupt affiliated company (i.e., within the "controlled group").

The Congress went one step further and said that the requirements for pension plans should not be so onerous that employers would not create new pension plans or improve existing plans. Therefore, it established the concept of contingent employer liability insurance (CELI), whereby the PBGC would develop an insurance system under which employers could protect themselves against all or part of the 30 percent liability.

One other aspect of ERISA will be noted here but developed in a subsequent section. The law provides for a phase-in of benefits guaranteed by the PBGC over a five-year period following the establishment of the plan or an amendment increasing the benefits. The intent is to balance the need to protect the PBGC against early termination of the plan with the need of employees to receive their vested benefits.

Probably the most difficult conceptual and developmental problem under ERISA is the establishment of a viable system of termination insurance incorporating the elements described above. The relationship among premiums, guaranteed benefits, employer liability, and CELI are extremely complex, with the development of a practical system at best difficult and perhaps impossible.

The goals of the PBGC in establishing levels of premiums, guaranteed benefits, employer liability, and CELI have been succinctly stated by the PBGC (in a paper defining the program objectives of CELI) as follows: To assure a financially sustainable program at reasonable premium levels; to provide adequate protection relative to the needs of plan participants, employers, and creditors; to minimize abuse; to minimize administrative complexity; and to balance social and equity considerations.

Relation to funding

It is natural to relate termination insurance to funding. Funding provides the first source to pay benefits—plan assets. Termination insurance provides the second. Although pension actuaries have been aware of the problem of termination since the advent of pension plans, no adequate solution has as yet been brought forward other than accelerated funding or conversion to a defined contribution plan.

The PBGC is, in effect, the reinsurer of pension benefits, with the pension trust the primary insurer. As a reinsurer, the PBGC thus provides excess coverage over the available assets, plus a deductible related to 30 percent of the net worth of the plan sponsor. If a defined benefit plan terminates at a time when the assets are not sufficient to provide all of the guaranteed benefits under ERISA, the PBGC (as agent for all other plan sponsors) must pay these unfunded benefits. If the plan had been better funded, the PBGC might not have to pay benefits; if the plan had been less well-funded, the PBGC liability would be greater. Despite this, funding at the maximum tax-deductible level does not guarantee that assets will be sufficient at all times to pay guaranteed benefits. Other plans using the minimum funding level still may have sufficient assets. Nevertheless, the plan adopting a faster funding schedule would have more assets at all times than if it adopted a slower funding schedule.

Unfortunately, the design of the deductible amount violates the basic principles of insurance. This results from the fact that the deductible amount is not predetermined and is based on an unrelated condition—the net worth of the plan sponsor. In addition, the insured (including plan participants through their collective bargaining representative) can increase the insured coverage (benefits) without the consent of the insurer (PBGC).

It is essential, therefore, that some return to these basic insurance principles be accomplished. That is, some risk must be borne by the decision-makers, be the decision-maker (a) the plan participants through establishment of higher insurance amounts, or (b) the plan sponsor through the failure to maintain adequate funding

or an adequate deductible (net worth). In the absence of an attempt to return to basic insurance principles (i.e., risk borne by related plan sponsors and their employees), the only solution can be excessive premiums (i.e., risk borne by unrelated plan sponsors) or application of general tax revenues (i.e., risk borne by the general taxpayer).

Levels of guaranteed benefits

Termination insurance under ERISA is intimately tied to the level of guaranteed benefits. Basic premium levels, PBGC liabilities, employer liabilities, and CELI will all be affected by the amounts of benefits that are guaranteed by the PBGC.

Two areas of major concern require attention in the legislated levels of guaranteed benefits. The first is early retirement benefits that exceed the actuarial equivalent of the accrued benefit payable at normal retirement age. The second is the existence and application of the phase-in rules.

Early retirement.—The PBGC approach on guaranteeing early retirement benefits is to compare the actual early-immediate pension with the actuarial equivalent of the maximum benefit payable at age 65. The higher of these two amounts is guaranteed. Therefore, the value of the plan's guaranteed early retirement benefit can be significantly greater than the value of the plan's guaranteed normal retirement pension if the maximum limits do not apply.

In determining the funding requirements for a plan, actuaries commonly assume—and experience bears them out—that only some of the employees eligible to retire early in any year will elect to do so. When a plan is terminated, however, the number of early retirements can be expected to increase significantly. This is especially true in the case of a complete shutdown of operations, where—under PBGC regulations—early retirement entitlement is extended to all employees who met the requirements for early retirement, except that they did not submit an application. When this happens, if the early retirement benefit is greater than the actuarial equivalent, substantial additional liability is thrust upon the plan. Depending on the levels of plan assets and employer net worth, this burden may reduce the benefits of other plan participants or may increase the liability of the employer or the PBGC (or, more appropriately, all other plan sponsors).

Consideration should be given to limiting the maximum guaranteed benefit on early retirement to the actuarial equivalent of either the participant's accrued retirement benefit or the ERISA maximum guaranteed benefit, whichever is lower. This concept is fully in accord with the social philosophy espoused by the Congress under the Social Security system. Social Security does not provide unreduced early retirement benefits except in the case of disability. Perhaps it was recognized, when Social Security was enacted, that unreduced early retirement benefits actually are unemployment insurance—and neither Social Security nor ERISA was designed to solve the social problems of unemployment.

Phase-in rules.—ERISA provides that only a graduated portion of the benefits that have been in effect under the plan for less than five years shall be guaranteed. The graduation, or phase-in, amounts to the greater of (a) 20 percent of such benefits, or (b) \$20 per month, multiplied by the number of years (up to five) they have been in effect under the plan. The phase-in concept is an obvious compromise between the need to prevent anti-selection by employers "dumping" liabilities on the PBGC (i.e., on all other plan sponsors) by adopting or improving a pension plan and soon thereafter terminating it, and the need to protect plan participants whose legitimately increased pensions are jeopardized by a justifiable plan termination.

The compromise, particularly the \$20 per month minimum for each year, seems to err on the side of excessive employee protection if there is to be a viable reinsurance program. If there were no phase-in of benefits for five years, or longer, the funding of pensions would be encouraged by participants. This might be reflected in the willingness of both labor and management to allow some of the pension dollars to be used to ensure the payment of the pensions promised rather than just to increase the benefits level. This would be beneficial to all phases of society involved with a pension plan—the employee, labor, the employer, and the government.

PROBLEMS WITH TERMINATION INSURANCE

The preceding section identified some of the problems with termination insurance under ERISA—namely, (a) the violation of sound financial and insurance principles, and (b) phase-in and early retirement aspects of the benefits that are guaranteed by the PBGC. Other critical problems have been recognized by the PBGC and have been reported to the Congress with the recommendations that changes should be made in the law. Still other problems are further away from solution. Viewed to-

gether, these problems fall basically into five areas of concern: Contingent employer liability insurance (CELI); lack of insolvency insurance; lack of a reorganization scheme for troubled plans; nature of the pension promise; and nature of the pension obligation (i.e., who pays the bill?).

Contingent employer liability insurance (CELI) and insolvency

At the present time, almost five years after the enactment of ERISA, it is almost universally agreed that CELI is unworkable. The PBGC, organized labor, industry representatives, and those in the insurance and pension fields agree that CELI should be abandoned. Financial economists concur unanimously. Since CELI has never been implemented, it appears likely that the Congress will change the law and enact an alternative.

The PBGC submitted a report to Congress in mid-1978 formally recommending the elimination of CELI and presenting several alternatives.² A brief summary of the PBGC's current proposal, so-called Alternative C, follows. (Alternatives A and B in the PBGC paper are not, as of now, being seriously considered.)

The central feature of Alternative C involves a separation of the concepts (although not necessarily the timing) of (a) voluntary termination, and (b) insurable event. Voluntary terminations as contemplated under Alternative C are events not presently permitted under ERISA, because they involve the loss of benefits in a pension plan which would continue to be maintained by the plan sponsor. Alternative C recognizes the reality of benefit losses (which can occur today when an employer chooses to end his obligation to further fund any plan benefits—colloquially referred to as a "freeze") and redefines the notion of voluntary termination.

A voluntary termination would occur under Alternative C when the plan is amended to provide that future service will no longer be credited for any purposes. As a part of the voluntary termination, the plan would also be amended to eliminate supplemental and ancillary benefits for which various plan participants had not satisfied all the requirements (e.g., death and disability benefits).

An insurable event would occur coincident with, or subsequent to, a voluntary termination when the employer sponsor demonstrates its financial inability to provide the guaranteed benefits to which participants are entitled to receive under the terms of the plan. The demonstration of such inability (i.e., business hardship) would take place in the bankruptcy courts in a business reorganization or insolvency proceeding. A new funding standard would apply to a voluntarily terminated plan. If the plan assets were less than the value of vested benefits, the deficiency would be required to be funded over a period of not more than ten to fifteen years. Actuarial losses would have to be funded over no more than five years.

Following a voluntary termination, employers ceasing business operations would be expected to discharge their pension obligations along with those to any other creditors. If such obligations could be met from existing plan assets (e.g., thorough purchase of annuities or lump sum distributions), the liquidating sponsor would, of course, have no further liability. If the business were liquidating pursuant to a bankruptcy processing, the pension plan claim would share in the liquidated assets of the business according to its level of priority in bankruptcy. If the plan's claim could not be satisfied in an amount sufficient to provide for guaranteed benefits, an insurable event would occur. The PBGC would become trustee and provide such benefits.

If, following a voluntary termination, a plan sponsor found itself so financially distressed that it was unable to meet its funding obligations, relief could be sought by requesting funding waivers. For example, the waiver of up to \$10,000 might be appropriate for employers experiencing operating losses. However, if the financial relief available to a plan sponsor through funding waivers proved insufficient, further relief would be available only through the bankruptcy reorganization process. The plan sponsor would petition the courts to reduce its general obligations, including those to the plan, to some lower and affordable level. Any reduction in the employer's obligation to the plan would necessitate the restructuring of the plan's liabilities to its participants.

The actual scope of such restructuring of plan benefits would be a by-product of the bankruptcy proceedings. If the adjustment of debt left the employer obligated for at least PBGC-guaranteed benefits, then the plan might continue—for example, as a frozen plan—even though a loss of non-guaranteed vested benefits may have resulted. Future payments to the plan could be made under the minimum funding standards, without PBGC involvement. On the hand, if the settlement with creditors

² Pension Benefit Guaranty Corporation. *Contingent Employer Liability Insurance: Status Report to the Congress*. July 1, 1978.

arising out of bankruptcy proceedings reduces the employer's obligation to less than guaranteed benefits, then an insurable event would occur and the PBGC would step in to make up the difference.

Reorganization for troubled plans

Plan termination does not often occur "out of the blue"; the signs of trouble are visible before the plan termination occurs. An analogy may be made to bankruptcy—a company's becoming bankrupt without signs of trouble first appearing as a warning is the exception, not the rule.

The analogy with bankruptcy may be carried one step further. Just as Chapter 11 of the United States federal bankruptcy laws provides an opportunity for a reorganization of a company in an attempt to avoid bankruptcy, so a major function of the PBGC should be to recognize these signs of trouble in a pension plan. If appropriate statutory authority were granted, the PBGC could step in and reorganize the plan in certain ways, thereby possibly avoiding plan termination. If plan termination were averted, then plan participants, the employer, the PBGC, and the general public would all benefit, and the private pension system would be strengthened. Unfortunately, ERISA created the PBGC to guarantee benefits, but it did not give the PBGC powers to step in and reorganize a troubled plan in an attempt to avert a plan termination in the same way that a court has powers under Chapter 11 to appoint trustees to reorganize a company. Title IV only permits the PBGC to force a complete termination.

The PBGC operates as an insurance company. Its practice should be more consistent with practices underlying an insurance company. There should be underwriting rules that, consistent with good business practice, preserve PBGC remedies while limiting PBGC liabilities. Thus, most of the responsibilities should be placed on the plan sponsors, since they control the plan. The PBGC's right to compel plans to take certain action stems from the PBGC's (i.e., other plan sponsors') ultimate obligation to provide benefits to employees covered under terminated plans.

The PBGC has submitted a bill (S. 1076) to the Congress this year which incorporates a plan reorganization program for multiemployer plans. This bill would also strengthen the minimum funding requirements for such plans. The essential points of the plan reorganization program set forth in this bill include:

1. *Employer withdrawal.*—A withdrawing employer would be required to continue its funding for a proportionate share of the plan's unfunded vested liability.

2. *Plan reorganization.*—A plan would be considered in a reorganization state if contributions were not sufficient to amortize the unfunded vested liabilities for benefits in pay status over 10 years, plus amortize the remaining unfunded vested liabilities over 25 years. (Assets would be applied first to determine the unfunded vested liabilities for benefits in pay status.)

- (a) A plan in reorganization could be amended to reduce accrued benefits derived from employer contributions to the level of benefits guaranteed by Title IV.

- (b) A plan in reorganization would be required to fund at a level sufficient to amortize unfunded vested liabilities at the amortization periods used to establish a reorganization state, subject to some adjustments (e.g., to reflect a declining contribution base during the remainder of the term of the establishing collective bargaining agreements).

- (c) Benefit levels applicable to past service could not be increased until all reduced benefits have been restored.

- (d) Benefit levels could not be increased in a year in which benefits are reduced.

- (e) A plan would not be considered voluntarily terminated until it becomes "insolvent."

3. *Plan insolvency.*—A plan in reorganization would be deemed "insolvent" when benefits have been reduced to the level of benefits guaranteed by Title IV and the plan is unable to meet the required reduced benefit payments. It is anticipated that plan insolvency would be linked to sponsor insolvency by law.

These proposals for plan reorganization of multiemployer plans are most important. They deserve serious consideration by the Congress and by all students of pension reinsurance programs. In addition, consideration needs to be given to comparable provisions for single employer plans.

Nature of the pension promise

Virtually no informed discussion has taken place in the United States regarding one of the most fundamental questions in determining a pension philosophy. That question is: What is the pension promise? Is the entire pension always compensation for services rendered in the past, or is part of the pension compensation for service to be rendered? An example may make this clear.

Company B hires John Smith at age 25. Company B tells John Smith, "We have a pension plan giving you a pension of \$10 a month for each year of service. If you work here until age 65, you will get a pension of \$400 a month." John Smith works 10 years and has earned a pension of \$100 a month. Company B then tells him, "We have agreed with your union to raise the pension from \$10 per month to \$20 per month for each year of work. Therefore, if you continue to work here until age 65 your pension will be \$800 a month, because not only will your future service be credited at the \$20 rate, but the new rate will apply to the past 10 years that you have been here." If John Smith is vested (and he probably is), his vested pension has suddenly doubled from \$100 to \$200. When was the additional \$100 earned? Was it earned the instant the increase was agreed to by Company B and the union, or is it being earned ratably over John Smith's expected future working years?

Historically, workers have seemed to feel that it was earned instantaneously. Certainly the South Bend employees at Studebaker and others who have felt victimized by the "broken promise" would agree. Perhaps the employer is remiss in not letting the employee know that the employer's true intention is somewhat as follows:

"We expect our future profits to be satisfactory as a result of your continuing to work for us. Therefore, we promise to use these future earnings to pay for your increased pension, as well as your increased wages."

In applying the empirical mathematical formula used to calculate the pension, this truth is not changed, regardless of whether or not past years of service are included.

Another example occurs often during the process of negotiating an acquisition or a sale where there is an unfunded past service liability. Company X is the seller, and the buyer says that Company X has to bear some responsibility with respect to the unfunded pension obligation. The buyer wants Company X either to reduce the asking purchase price, or to give credit for the existing unfunded obligation. Company X intended to pay for that liability out of its future earnings. Company X has reflected on the economic effect of the sale to that point, the amount of money Company X has funded, and the cost of the pension plan to the point of sale. The buyer has, presumably, taken Company X's economic experience, including its projected pension expense, capitalized it, and determine a reasonable purchase price. The question, then, is whether the buyer is asking Company X to pay for the pensioners twice.

Nature of the pension obligation

The fundamental issue confronting insolvency insurance is who should bear the cost. Any system of insolvency insurance is, by definition, inequitable. Given: A return to basic insurance principles; higher funding levels; lower guaranteed benefits; prohibition of plan termination for solvent employers; and a plan reorganization procedure, who pays the bill?

Title IV of ERISA looks first to the plan sponsor or sponsors, including all corporations with common ownership (i.e., the controlled group concept). This controlled group concept has been affirmed in federal District Court (*PBGC v. Ouimet Corporation and others*), but the issue has not yet reached the United States Supreme Court. An interesting sidelight is whether United States law can reach beyond the boundaries of the United States to foreign parent corporations.

Since the first financial resource is the plan sponsor, an interesting question is where the obligation falls with respect to other creditors in a liquidation situation. Will mortgage holders, bond holders, and other preferred creditors be displaced by a higher claim? Even more drastic, perhaps, is whether unpaid wages will be displaced. These are major issues not as yet tested in the courts nor understood by most Americans.

The second financial resource is the PBGC. But the PBGC is not a source of funding. It has no resources other than premiums received from plan sponsors. It has a financial "call" solely upon unrelated, ongoing plan sponsors—no one else. It is, in essence, a contingent pension obligation clearing house.

Thus the ultimate reinsurer is all other plan sponsors. Yet they will find no relief from this potential burden by adequately funding their own plans. There is no relief in Title IV of ERISA for plan sponsors who soundly fund their own plans. A resource, theoretically, is again tax revenues, from which the Congress has carefully excluded the PBGC. But, Social Security has exhausted this source of revenues, with the Congress attempting to find ways to balance the still unbalanced Social Security budget.

CONCLUSION

The private pension system in the United States today continues to evolve in size and complexity (see Tables 1-2 through 1-11). New needs are recognized by society almost daily. The participants in the pension system—employers, unions, the government, practitioners—are all demanding more of the system. The ultimate fate of the private pension system depends on whether future changes will be economically and socially sound, or irrational. Decisions made in the next several years in the areas discussed here—funding, plan termination, insolvency, reorganization, the basic nature of the pension promise, and, most important of all, the ultimate financial resource—will be critical in determining the future of the private pension system in the United States.

TABLE 1-2.—U.S. POPULATION: 1900 to 1978

(In millions, except as indicated. Estimates as of July 1, except as indicated. Prior to 1940, excludes Alaska and Hawaii. Total population includes Armed Forces abroad; resident population excludes them. See text, p. 2, for basis of estimates. See also Historical Statistics, Colonial Times to 1970, series A 6-8.)

Year	Resident population	Year	Resident population	Year	Total			Year and month	Total		
					Population	Percent change	Resident population		Population	Percent change	Civilian population
1900	76.1	1920	106.5	1940	132.6	1.3	132.5	132.1	186.6	1.5	183.7
1901	77.6	1921	108.5	1941	133.9	1.0	133.7	132.1	189.2	1.4	186.5
1902	79.2	1922	110.1	1942	135.4	1.1	134.6	131.4	191.9	1.4	189.1
1903	80.6	1923	112.0	1943	137.3	1.4	135.1	128.0	194.3	1.3	191.6
1904	82.2	1924	114.1	1944	138.9	1.2	133.9	127.2	196.6	1.2	193.4
1905	83.8	1925	115.8	1945	140.5	1.1	133.4	128.1	198.7	1.1	195.3
1906	85.4	1926	117.4	1946	141.9	1.0	140.7	138.9	200.7	1.0	199.4
1907	87.0	1927	119.0	1947	144.1	1.9	144.1	143.1	202.7	1.0	201.4
1908	88.7	1928	120.5	1948	147.2	1.7	146.7	145.7	204.9	1.1	203.8
1909	90.5	1929	121.8	1949	149.8	1.7	149.3	148.2	207.1	1.1	206.2
1910	92.4	1930	123.1	1950	152.3	1.7	151.9	150.8	208.8	.9	208.2
1911	93.9	1931	124.1	1951	154.0	1.7	154.0	151.6	210.4	.7	209.9
1912	95.3	1932	124.8	1952	157.6	1.7	156.4	153.9	211.9	.7	211.4
1913	97.2	1933	125.6	1953	160.2	1.7	159.0	156.6	213.6	.8	213.1
1914	99.1	1934	126.4	1954	163.0	1.8	161.9	159.7	215.1	.7	214.7
1915	100.5	1935	127.3	1955	165.9	1.8	165.1	163.0	216.8	.8	216.3
1916	102.0	1936	128.1	1956	168.9	1.8	168.1	166.1	217.7	.43	217.3
1917	103.3	1937	128.8	1957	172.0	1.8	171.2	169.1	217.8	.04	217.4
1918	103.2	1938	129.8	1958	174.9	1.7	174.1	172.2	217.9	.05	217.5
1919	104.5	1939	130.9	1959	177.8	1.7	177.1	175.3	218.1	.07	217.6
			1960	1960	180.7	1.6	180.0	178.1			
			1961	1961	183.7	1.7	183.0	181.1			

Source: U.S. Bureau of the Census, Current Population Reports, series P-25, Nos. 706 and 724.

TABLE 1-3.—U.S. POPULATION: PROJECTED NUMBER OF PERSONS AGE 65 AND OVER IN THE UNITED STATES

	Number of persons age 65 and over (million)	Percent of total population
Year:		
1976.....	22.9	10.7
2000.....	31.8	11.3-12.9
2030.....	55.0	14.0-22.0

Source: U.S. Bureau of Census. Percentages for years 2000 and 2030 depend on fertility levels used in population projections.

TABLE 1-4.—U.S. LABOR FORCE: NO. 643. LABOR FORCE AND EMPLOYMENT: 1947 to 1978

[Persons 16 yrs old and over. Annual averages of monthly figures, except as indicated. See also Historical Statistics, Colonial Times to 1978, series D 11-19 and D 85-86]

Year:	Total labor force ¹			Civilian Labor force				Not in labor force				
	Total noninstitutional population ¹ (million)	Total (million)	Percent of noninstitutional population	Female		Employed		Unemployed		Total (million)	Percent of noninstitutional population	
				Total (million)	Percent of civilian labor force	Total (million)	Percent of noninstitutional population	Total (million)	Percent of civilian labor force			
1947.....	103.4	60.9	58.9	59.4	16.7	28.1	57.0	55.2	2.3	3.9	42.5	41.1
1950.....	106.6	63.9	59.9	62.2	18.4	29.6	58.9	55.2	3.3	5.3	42.8	40.1
1955.....	112.7	68.1	60.4	65.0	20.5	31.6	62.2	55.2	2.9	4.4	44.7	39.6
1960.....	119.8	72.1	60.2	69.6	23.2	33.4	65.8	54.9	3.9	5.5	47.6	39.8
1965.....	129.2	77.2	59.7	74.5	26.2	35.2	71.1	55.0	3.4	4.5	52.1	40.3
1966.....	131.2	78.9	60.1	75.8	27.3	36.0	72.9	55.6	2.9	3.8	52.3	39.9
1967.....	133.3	80.8	60.6	77.3	28.4	36.7	74.4	55.8	3.0	3.9	52.5	39.4
1968.....	135.6	82.3	60.7	78.7	29.2	37.1	75.9	56.0	2.8	3.6	53.3	39.3
1969.....	137.8	84.2	61.1	80.7	30.5	37.8	77.9	56.5	2.8	3.5	53.6	38.9
1970.....	140.2	85.9	61.3	82.7	31.5	38.1	78.6	56.1	4.1	4.9	54.3	38.7
1971.....	142.6	86.9	61.0	84.1	32.1	38.2	79.1	55.5	5.0	5.9	55.7	39.0
1972.....	145.8	89.0	61.0	85.5	33.3	38.5	81.7	56.0	4.8	5.6	56.8	39.0
1973.....	148.3	91.0	61.4	88.7	34.5	38.9	84.4	56.9	4.3	4.9	57.2	38.6
1974.....	150.8	93.2	61.8	91.0	35.8	39.4	85.9	57.0	5.1	5.6	57.6	38.2
1975.....	153.4	94.8	61.8	92.6	37.0	39.9	84.8	55.3	7.8	8.5	58.7	38.2
1976.....	156.0	96.9	62.1	94.8	38.4	40.5	87.5	56.1	7.3	7.7	59.1	37.9
1977.....	158.6	99.5	62.8	97.4	40.0	41.0	90.5	57.1	6.9	7.0	59.0	37.2
1978, Jan.-Apr. ²	160.2	101.5	63.3	99.3	41.1	41.4	93.2	58.2	6.1	6.2	58.7	36.7

¹ Includes Armed Forces.² Seasonally adjusted, except population figure.

Source: U.S. Bureau of Labor Statistics, Employment and Earnings, monthly.

TABLE 1-5.—SOCIAL SECURITY COVERAGE: OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE

[In thousands]

Year:	Persons with earnings credits year-end ¹	Persons employed with coverage in effect year-end	Employer and worker taxes in year	Persons fully insured year-end ²	Persons receiving monthly benefits year-end	Monthly and lump sum payments in year
1945	72,400	39,200	\$1,285,486	33,400	1,288	\$273,885
1950	82,700	41,000	2,667,077	59,800	3,478	961,094
1955	98,600	56,200	5,713,045	70,500	7,960	4,962,155
1960	109,400	59,000	11,876,220	84,400	14,844	11,244,795
1965	121,300	66,400	17,205,372	94,800	20,867	18,310,676
1966	125,000	69,000	22,585,229	97,200	22,767	20,048,347
1967	127,900	69,900	25,423,792	99,900	23,707	21,406,455
1968	130,800	71,300	27,034,289	102,600	24,562	24,936,435
1969	133,500	72,700	31,545,608	105,400	25,314	26,750,841
1970	135,900	72,700	34,737,059	108,200	26,229	31,863,381
1971	138,200	73,100	38,342,721	110,600	27,291	37,170,726
1972	140,600	75,500	42,888,228	113,200	28,476	41,595,064
1973	142,900	78,100	51,907,100	116,400	29,868	51,459,310
1974	145,200	79,300	58,906,577	119,800	30,854	58,521,344
1975	148,300	78,300	64,259,394	122,800	32,085	66,922,707
1976	150,900	80,700	71,594,624	126,400	33,024	75,664,649
1977	153,000	83,400	78,710,397	128,200	34,082	84,575,800

¹ Social Security Administration estimate of persons who have ever had covered earnings.² Beginning in 1965, figures include transitionally insured persons. Data represent number insured at beginning of following year.

Note.—Data are revised.

Source: Social Security Administration, U.S. Department of Health, Education and Welfare. Data pertaining to the "Medicare" program are not included in this table. Data for 1977 pertaining to coverage and insured status are estimated.

TABLE 1-6.—RETIREMENT PLAN COVERAGE: NUMBER OF PERSONS COVERED BY MAJOR PENSION AND RETIREMENT PROGRAMS IN THE UNITED STATES

[In thousands]

Year:	Private plans		Government-administered plans			OASDI ^a
	With life insurance companies	Other private plans	Railroad retirement	Federal civilian employees ¹	State and local employees	
1940	695	3,565	1,349	745	1,552	27,622
1945	1,470	5,240	1,846	2,928	2,008	40,488
1950	2,755	7,500	1,881	1,873	2,894	44,477
1955	4,105	12,290	1,876	2,333	3,927	64,161
1960	5,475	17,540	1,654	2,707	5,160	73,845
1961	5,635	18,440	1,662	2,855	5,309	76,295
1962	5,770	19,370	1,643	2,943	5,654	78,953
1963	6,060	19,990	1,664	2,985	5,940	81,035
1964	6,710	20,350	1,650	3,069	6,330	83,400
1965	7,040	21,060	1,661	3,114	6,780	87,267
1966	7,835	21,710	1,666	3,322	7,210	91,768
1967	8,700	22,330	1,641	3,499	7,594	93,607
1968	9,155	22,910	1,625	3,565	8,012	95,862
1969	9,920	24,410	1,620	3,627	8,303	98,012
1970	10,580	25,520	1,633	3,625	8,591	98,935
1971	10,880	26,580	1,578	3,596	9,079	100,392
1972	11,545	27,400	1,575	3,737	9,563	103,976
1973	12,485	28,700	1,582	4,030	10,050	108,268
1974	13,335	29,240	1,589	4,052	10,835	108,854
1975	15,195	30,300	1,574	4,130	11,230	110,085
1976	16,985	31,400	1,565	4,184	^a 12,000	113,724

TABLE 1-6.—RETIREMENT PLAN COVERAGE: NUMBER OF PERSONS COVERED BY MAJOR PENSION AND RETIREMENT PROGRAMS IN THE UNITED STATES—Continued

[In thousands]

	Private plans		Government-administered plans			
	With life insurance companies	Other private plans	Railroad retirement	Federal civilian employees ¹	State and local employees	OASDI ²
1977	19,240	^a 32,500	^a 1,572	^a 4,288	^a 12,500	117,482

¹ Includes members of the U.S. Civil Service Retirement System, the Tennessee Valley Retirement System, the Foreign Service Retirement System, and the Retirement System of the Federal Reserve Banks, which includes the Bank Plan and the Board of Governors' Plan.

² Includes persons employed with coverage in effect at year-end including the self-employed, workers retired for age or disability, dependents of retired workers and survivors of deceased workers who are receiving periodic benefits.

^a Estimated.

Note 1. It is not possible to obtain a total for number of persons covered by pension plans by adding together the figures shown by year. Each series has been derived separately and there are differences in amount of duplication within each series and among the various series and also differences in definition of "coverage" among the series. In addition, private plans with life insurance companies include persons covered by Keogh plans, tax-sheltered annuities and, after 1974, IRA plans, but other private plans do not include persons covered by these plans.

Note 2. These data represent various dates during the year, since the fiscal years of the plans are not necessarily the same. Trends from year to year within each series are not affected. The number of persons covered include survivors or dependents of deceased workers and beneficiaries as well as retired workers. Retirement arrangements for members of the armed forces, and provisions for veterans pensions, are not included. Persons covered by private plans and many persons covered by government-administered plans are also usually covered by Social Security. Data for "Other Private Plans", compiled by the Social Security Administration, exclude plans for the self-employed, those having vested benefits but not presently employed at the firm where benefits were accrued, and also exclude an estimated number who have vested benefits from employment other than from their current employment.

Source: Compiled by the American Council of Life Insurance.

TABLE 1-7.—RETIREMENT PLAN COVERAGE: NO. 539. PRIVATE PENSION AND DEFERRED PROFIT-SHARING PLANS: 1950 TO 1975

[Includes pay-as-you-go, multiemployer, union, administered, and nonprofit organization plans, and railroad plans supplemental the Federal railroad retirement program. Plans are classified as insured and noninsured, the former underwritten by insurance companies and the latter generally funded through trustees. See also Historical Statistics, Colonial Times to 1970, series 11 287-304]

Item and type of plan	1950	1955	1960	1965	1970	1972	1973	1974	1975
Coverage, net ^{1 2} (thousands)	9,800	14,200	18,700	21,800	26,300	27,500	29,200	29,800	30,300
Insured plans, gross (thousands)	2,600	3,800	4,900	6,200	8,900	9,500	10,200	10,800	11,600
Noninsured plans, gross (thousands)	7,200	11,600	16,300	19,100	22,000	24,000	25,600	26,200	26,800
Contributions (in millions of dollars):									
Employer.....	\$1,750	\$3,280	\$4,710	\$7,370	\$12,580	\$16,940	\$19,390	\$23,020	\$27,560
Insured plans	720	1,100	1,190	1,770	2,860	4,200	5,020	6,050	7,730
Noninsured plans	1,030	2,180	3,520	5,600	9,720	12,740	14,370	16,970	19,830
Employee	330	560	780	990	1,420	1,600	1,710	2,000	2,290
Insured plans	200	280	300	320	350	400	440	540	690
Noninsured plans	130	280	480	670	1,070	1,200	1,270	1,460	1,600
Monthly beneficiaries ¹ (thousands)	450	980	1,780	2,750	4,740	5,550	6,080	6,390	7,050
Insured plans (thousands)	150	290	540	790	1,220	1,350	1,480	1,550	1,690
Noninsured plans (thousands)	300	690	1,240	1,960	3,520	4,200	4,600	4,840	5,360
Benefit payments ² (in millions of dollars)	370	850	1,720	3,520	7,360	10,000	11,220	12,930	14,810
Insured plans (in millions of dollars) ..	80	180	390	720	1,330	1,700	1,910	2,190	2,480
Noninsured plans ³ (in millions of dollars)	290	670	1,330	2,800	6,030	8,300	9,310	10,740	12,330
Reserves ¹ (in billions of dollars)	12.1	27.5	52.0	86.5	137.1	167.8	180.2	191.7	212.6
Insured plans (in billions of dollars) ..	5.6	11.3	18.8	27.3	40.1	50.3	53.4	58.0	67.4
Noninsured plans (in billions of dollars)	6.5	16.1	33.1	59.2	97.0	117.5	126.5	133.7	145.2

¹ As of end of year.

² Includes beneficiaries.

³ Includes refunds and lump sums.

Source: U.S. Social Security Administration, Social Security Bulletin, November 1977.

NO. 540. PRIVATE NONINSURED PENSION FUNDS: 1960 TO 1977

[In millions of dollars. Covers all pension funds of corporations, nonprofit organizations, unions, and multi-employer groups, except those managed by insurance companies. Also includes deferred profit-sharing plans, excludes health, welfare, and bonus plans.
Minus sign (—) denotes loss]

Assets, receipts, and disbursements	1960	1965	1970	1972	1973	1974	1975	1976	1977, prel.
Total assets ¹ a	33,140	59,180	97,010	117,530	126,530	133,731	145,166	160,414	181,509
Cash and deposits	550	940	1,800	1,860	2,340	4,286	2,962	2,199	3,721
U.S. Government securities	2,680	2,990	3,030	3,690	4,400	5,533	10,764	14,713	20,138
Corporate bonds	15,700	23,130	29,670	28,210	30,330	35,029	37,809	39,070	45,580
Preferred and common stock	11,510	25,870	53,480	76,060	81,850	80,488	84,842	94,609	98,152
Mortgages	1,300	3,380	4,170	2,730	2,380	2,372	2,393	2,369	2,497
Receipts ¹ a	5,410	9,280	13,200	20,070	19,670	21,060	26,583	(NA)	(NA)
Employer contributions	3,520	5,600	9,720	12,740	14,370	16,970	19,828	(NA)	(NA)
Employee contributions	480	670	1,070	1,200	1,270	1,460	1,604	(NA)	(NA)
Investment income	1,260	2,390	3,870	4,300	4,840	5,980	6,703	(NA)	(NA)
Net profit on sale of assets	110	570	—	1,720	—	—	—	(NA)	(NA)
Disbursements	1,370	2,880	6,180	8,490	9,540	11,030	12,597	(NA)	(NA)
Benefits paid out	1,330	2,800	6,030	8,300	9,310	10,740	12,334	(NA)	(NA)
Expenses and other	50	90	150	200	230	290	263	(NA)	(NA)
Net receipts	4,040	6,400	7,020	11,580	10,130	10,030	13,986	(NA)	(NA)

NA, Not available.

¹ Book value, end of year.

^a Includes other items, not shown separately.

Source: U.S. Securities and Exchange Commission, Statistical Bulletin, monthly.

TABLE 1.8.—RETIREMENT PLAN RESERVES: ASSETS AND RESERVES OF MAJOR PENSION AND RETIREMENT PROGRAMS IN THE UNITED STATES (BOOK VALUES)

[In thousands]

	Private plans			Government-Administered Plans					Old-age, survivors and disability insurance
	With life insurance companies	Other private plans	Total	Railroad retirement	Federal civilian employees	State and local employees	Total		
1950.....	\$5,600	\$6,500	\$12,100	\$2,553	\$4,343	\$5,154	\$12,050	\$13,721	
1960.....	18,850	33,100	51,950	3,740	10,790	19,600	34,130	22,613	
1965.....	27,325	59,200	86,525	3,946	16,516	33,100	53,562	19,841	
1966.....	29,425	66,200	95,625	4,074	17,619	36,900	58,593	22,308	
1967.....	32,000	74,200	106,200	4,236	18,799	41,500	64,535	26,250	
1968.....	34,975	83,100	118,075	4,245	20,224	46,300	70,769	28,729	
1969.....	37,900	90,600	128,500	4,347	21,600	51,800	77,747	34,182	
1970.....	41,175	97,000	138,175	4,398	23,100	58,100	85,598	38,068	
1971.....	46,400	106,400	152,800	4,300	26,400	64,400	95,100	40,434	
1972.....	52,300	117,500	169,000	4,100	29,200	72,200	105,500	42,775	
1973.....	56,050	126,500	182,550	3,800	31,500	81,600	116,900	44,414	
1974.....	60,775	133,700	194,475	3,600	34,600	89,000	127,200	45,886	
1975.....	71,700	145,200	216,900	3,100	38,600	106,500	147,700	44,342	
1976.....	88,400	160,400	248,800	3,100	43,500	117,200	163,800	41,133	

¹ Beginning in 1957, assets of Disability Insurance Trust Funds are included. Health and Supplementary Medical Insurance is not included.

Note: Data are revised. These data are as of various dates during the year, since the fiscal years of the plans are not necessarily the same. Trends from year to year are not affected.

Sources: Railroad Retirement Board, Social Security Administration, Securities and Exchange Commission, other administrative agencies and the American Council of Life Insurance.

TABLE 1-9.—EMPLOYMENT BENEFIT PLAN COVERAGE: NO. 542. EMPLOYEE-BENEFIT PLANS—SUMMARY: 1960 TO 1975

[Coverage data refer to civilian wage and salary workers at end of year; contributions, to amounts subscribed by employers and employees, in total. An "employee-benefit plan" is any type of plan sponsored or initiated unilaterally or jointly by employers or employees and providing benefits that stem from the employment relationship and that are not underwritten or paid directly by government (Federal, State, or local). In general, the intent is to include plans that provide in an orderly predetermined fashion for (1) income maintenance during periods when regular earnings are cut off because of death, accident, sickness, retirement, or unemployment and (2) benefits to meet medical expenses. Excludes workmen's compensation required by statute and employer's liability. See also Historical Statistics, Colonial Times to 1970, series II 70-114.]

Item and type of plan	1960	1965	1970	1972	1973	1974	1975
Covered employees (millions):							
Life insurance and death ¹	34.2	41.9	51.8	55.2	57.8	60.6	62.4
Accidental death and dismemberment.....	20.9	28.4	38.7	40.7	42.7	44.3	46.5
Health benefits:							
Hospitalization ²	39.3	45.7	53.1	54.2	56.8	57.6	58.2
Surgical ³	37.4	43.4	51.5	52.9	55.4	56.1	56.6
Regular medical ⁴	28.2	38.2	48.0	49.4	53.7	54.9	56.1
Major medical ⁴	8.8	16.6	24.6	26.4	27.6	28.2	29.6
Coverage, private employees (millions):							
Temporary disability ⁵	⁶ 24.5	24.5	29.7	31.3	32.0	31.7	31.1
Long-term disability.....	(⁶)	1.9	7.0	9.5	10.6	11.1	11.5
Retirement ⁷	18.7	21.8	26.1	27.5	29.2	29.8	30.3
Contributions (in billions of dollars):							
All employees, total ⁸	12.5	19.9	34.9	45.4	50.5	57.7	67.3
Life insurance and death ¹	1.4	2.2	3.6	4.3	4.4	4.7	5.1
Accidental death and dismemberment.....	.1	.1	.2	.3	.3	.3	.3
Health benefits:							
Hospitalization ³	2.5	4.3	7.6	9.5	10.5	11.4	13.3
Surgical and regular medical.....	1.3	2.1	4.0	5.2	5.9	7.0	8.2
Major medical ⁴	.5	1.1	2.3	3.6	4.1	4.6	5.7
Private employees:							
Temporary disability ⁵	1.2	1.6	3.1	8.7	3.9	4.4	4.7
Retirement ⁷	5.5	8.4	14.0	18.5	21.1	25.0	29.9
Benefits paid (in billions of dollars):							

TABLE 1-9.—EMPLOYMENT BENEFIT PLAN COVERAGE: NO. 542. EMPLOYEE-BENEFIT PLANS—
SUMMARY: 1960 TO 1975—Continued

[Coverage data refer to civilian wage and salary workers at end of year; contributions, to amounts subscribed by employers and employees, in total. An "employee-benefit plan" is any type of plan sponsored or initiated unilaterally or jointly by employers or employees and providing benefits that stem from the employment relationship and that are not underwritten or paid directly by government (Federal, State, or local). In general, the intent is to include plans that provide in an orderly predetermined fashion for (1) income maintenance during periods when regular earnings are cut off because of death, accident, sickness, retirement, or unemployment and (2) benefits to meet medical expenses. Excludes workmen's compensation required by statute and employer's liability. See also Historical Statistics, Colonial Times to 1970, series # 70-114.]

Item and type of plan	1960	1965	1970	1972	1973	1974	1975
All employees, total ^a	7.8	13.6	26.1	32.9	36.2	42.0	47.9
Life insurance and death	1.0	1.6	2.5	2.9	3.2	3.4	3.6
Accidental death and dismemberment	(¹¹)	.1	.2	.2	.2	.3	.3
Health benefits:							
Hospitalization ^a	2.4	4.2	7.3	8.9	9.6	11.1	13.1
Surgical and regular medical	1.1	1.8	3.6	4.5	5.2	6.3	7.4
Major medical ^a	.4	1.0	2.4	3.2	3.4	4.0	4.5
Private employees:							
Temporary disability ^a	1.0	1.3	2.5	3.0	3.2	3.7	3.8
Retirement ^c	1.7	3.5	7.4	10.0	11.2	12.9	14.8
Percent of workers covered ¹⁰							
All employees:							
Life insurance and death	57.8	63.7	69.0	71.1	71.2	73.5	77.3
Accidental death and dismemberment	35.3	43.1	51.5	52.4	52.7	53.7	57.6
Health benefits:							
Hospitalization	66.5	69.4	70.7	69.8	70.0	69.9	72.2
Surgical	63.3	65.9	68.6	68.1	68.3	68.1	70.1
Regular medical	47.7	58.0	63.9	63.6	66.2	66.5	69.5
Major medical	14.8	25.2	32.7	34.0	34.0	34.2	36.7
Private employees:							
Temporary disability	^a 48.7	44.3	47.9	49.1	47.9	46.8	47.5
Long-term disability	(^a)	3.4	11.2	14.8	15.8	16.4	17.6
Retirement	37.2	39.5	42.1	43.1	43.7	44.0	46.2
Percent contributions of total wages and salaries ¹⁰							
All employees:							
Life insurance and death	.54	.64	.68	.71	.65	.63	.65
Accidental death and dismemberment	.03	.03	.04	.05	.04	.04	.04
Health benefits	1.63	2.15	2.64	2.98	3.02	3.11	3.45
Private employees:							
Temporary disability	.53	.54	.71	.76	.71	.73	.75
Retirement	2.46	2.86	3.25	3.74	3.82	4.14	4.73

^a Includes group and wholesale life insurance but excludes Servicemen's Group Life Insurance program.

^b Includes persons covered by group comprehensive major-medical insurance as well as those with basic benefits.

^c Includes private hospital plans written in compliance with State temporary disability insurance law in California.

^d Group supplementary and comprehensive major-medical insurance written by commercial insurance companies.

^e Includes private plans written in compliance with State temporary disability insurance laws in California, Hawaii, New Jersey, and New York; and formal sick-leave plans. Excludes credit accident and health insurance.

^f Long-term disability policies included in temporary disability.

^g Includes pay-as-you-go and deferred profit-sharing plans, plans for non-profit organizations, union pension plans, and railroad plans supplementing the Federal railroad retirement program. Excludes plans for the self-employed and tax-sheltered annuities. Retirement coverage estimates exclude annuitants.

^h Includes data for supplemental unemployment insurance benefits, not shown separately.

ⁱ Includes data under long-term disability policies.

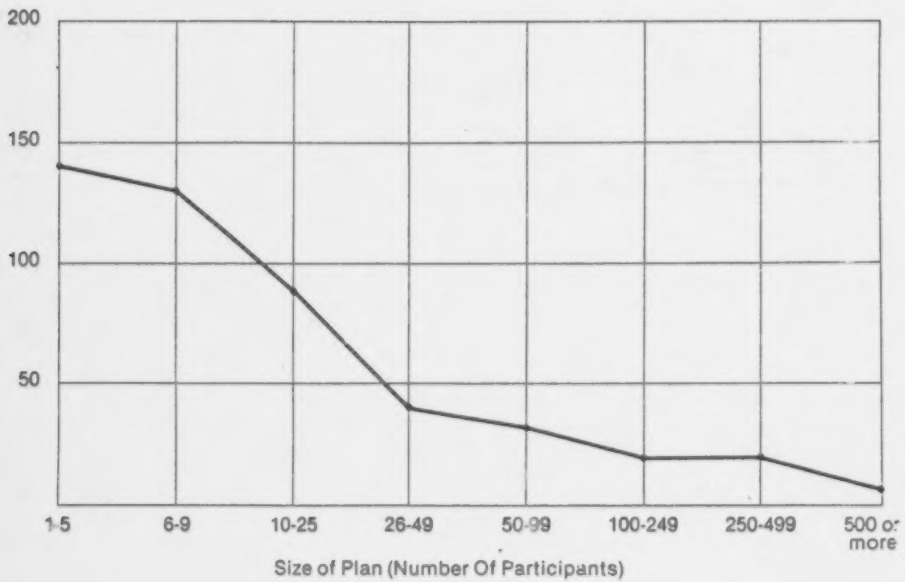
¹⁰ For all employees, coverage and contributions relate to private and government full-time and part-time civilian employees and payroll; for private employees, to wage and salary full-time and part-time labor force and payroll in private industry.

¹¹ Less than \$50 million.

Source: U.S. Social Security Administration, Social Security Bulletin, November 1977.

Table 1-11

PLAN TERMINATION IN THE UNITED STATES

FREQUENCY OF TERMINATION BY SIZE OF PLAN,
FISCAL YEAR 1977

SOURCE: Pension Benefit Guaranty Corporation

EBRI—RETIREMENT INCOME OPPORTUNITIES IN AN AGING AMERICA: PENSIONS AND THE ECONOMY

(By Sophie M. Korczyk)

FUNDING STATUS OF MAJOR CATEGORIES OF RETIREMENT INCOME PROGRAMS

This chapter presents data on asset accumulation and plan funding status in private, state and local government, and Federally-financed retirement income programs. It also discusses plan termination experience in private defined-benefit plans.

INTRODUCTION

Pension-fund assets have become a major source of investment funds. By the end of 1981, pension assets totaled \$850.1 billion. Nearly two-thirds of all pension assets were held by private defined benefit and defined contribution plans in 1981, with most of the remainder concentrated in state and local government plans (Table II-I).

TABLE II-1.—PENSION-FUND ASSETS: SELECTED YEARS

[In billions of dollars]

Year: ¹	Private plans ²	State and local government	OASDI ³	Federal Civil Service	Total
1950.....	12.0	5.3	13.7	4.2	35.2
1955.....	27.4	10.5	21.7	6.5	66.1
1960.....	52.0	19.3	20.3	10.5	102.1
1965.....	86.5	33.2	18.2	15.9	153.8
1970.....	138.2	58.1	32.5	23.1	251.9
1971.....	152.8	64.8	40.4	26.4	283.7
1972.....	169.8	73.3	42.8	29.2	315.1
1973.....	182.6	82.7	44.4	31.5	341.2
1974.....	194.5	94.0	45.9	34.6	369.0
1975.....	210.7	108.2	44.6	38.3	401.8
1976.....	248.8	120.8	41.1	45.8	456.5
1977.....	290.2	130.5	35.9	52.6	509.7
1978.....	321.3	148.5	31.7	60.6	562.1
1979.....	424.0	169.7	27.7	64.0	685.4
1980.....	500.3	198.1	24.6	73.0	796.0
1981.....	520.2	222.1	23.8	84.4	850.1

¹ End-of-year totals.

² Total includes insured and noninsured plans.

³ Federal disability insurance only included in totals from 1960 on.

Sources: Asset totals from Federal Reserve Board of Governors, Banking and Monetary Statistics, 1941-70 and Annual Statistical Digest, various years.

Since defined contribution plans are always fully funded, the asset level and asset growth are statements of condition. Asset growth, however, does not alone tell much about the financial condition of defined benefit plans. To understand a defined benefit plan's condition, it is necessary to measure such features as the adequacy of assets relative to benefit obligations, and the cost impact of the plan on the sponsoring firm.

No single measure alone provides a satisfactory assessment of the financial condition of defined benefit pension plans, and no one measure fits all needs. Estimates of unfunded actuarial liabilities are used the most frequently, however. Unfunded vested liabilities are used to compare benefit security among plans and are also used as a rough measure of the PBGC's potential liability for guaranteed benefits in an insured plan. Under certain circumstances, however, unfunded accrued liabilities—vested or not—also provide a measure of plan funding status. At termination, for example, all accrued benefits become vested to the extent funded, which means that well-funded plans may have liabilities in excess of vested benefits. Using unfunded

actuarial liabilities alone as a measure of benefit security can produce an overly pessimistic view of plan funding status, however.¹ This measure fails to recognize the value of the plan of the future stream of sponsor's earnings and contributions. In addition, the use of different actuarial methods and assumptions can provide substantially different pictures of the funding status of any single plan, making comparisons among plans hazardous.

While unfunded vested liabilities are an important measure of plan financial status for public-policy purposes, other measures of plan financial condition are often used to assess the plan's impact on the sponsor.

A frequently used measure of pension funding trends is the value of annual pension costs as a percentage of payroll. Estimates of plan costs as a percentage of payroll may provide a basis for evaluating changes in the allocation of pension costs over time. Achieving the desired allocation of contributions over time and across groups of the population is a major objective of funding.

Other measures have been used to examine plan benefit security or the pattern of plan costs. For example, measures such as the ratio of plan assets to annual benefit payments, or the ratio of annual contributions to sponsor profitability may often provide information about the benefit security status or the costs of pension plans. If these measures are available for a number of periods, they can provide a historical perspective on the plan's current status. Problems of data availability and lack of comparability across plans, however, reduce the usefulness of these measures when applied to large samples of pension plans.

Some of the same measures that can be used to assess private-plan funding status are also appropriate for assessing the status of State and local government plans, because some of these plans are advance-funded in a manner resembling private plans. Federally-funded plans, however, tend to be pay-as-you-go plans. As a result, their funding status is more appropriately assessed in terms of Federal budget priorities and economic policy.

CURRENT STATUS OF PRIVATE EMPLOYER PLANS

This section discusses the funding status of large, small, and multi-employer defined-benefit plans, and also presents data on asset growth in defined-contribution plans.

Large single-employer pension plans

There were over 500 single-employer plans with more than 1000 participants in operation at the end of 1977, the most recent year for which IRS disclosure data are available. Single-employer plans with more than 1000 participants accounted for more than 78 percent of all defined-benefit participants, making these plans important in the retirement picture. Large defined-benefit plans are well able to meet current pension obligations. Close to half of these plans were fully-funded or over-funded, and 70 percent were at least 75 percent funded (Table II-2).²

TABLE II-2.—*Percent distribution of large single-employer defined benefit plans by funding ratio: 1977*¹

<i>Funding ratio</i> ²	<i>Percent of plans</i> ³
25 percent or more.....	98
50 percent or more.....	88
75 percent or more.....	70
100 percent or more.....	47
Number of plans reporting.....	2,091

¹ Plan classification by type is that used by the Department of Labor.

² Ratio of plan assets to vested liabilities. Assets value is actuarial value, which adjusts for short-term fluctuation.

³ Data do not include plans filing late. About 25 percent of respondents filed late in 1977.

Source: EBRI tabulations of IRS disclosure data.

Studies of large corporate pension plans also show that the net worth of most sponsors is more than adequate to meet unfunded vested liabilities. Over 90 percent

¹ For a discussion of this issue, see Employee Benefit Research Institute, Retirement Income Policy: Considerations for Effective Decision Making, (Washington, D.C. 1980).

² For smaller-group studies of large-plan funding status, see ICF, Inc., "Background Data on Funding Status, Costs and Liabilities of Pension Plans, 1979-1980", April, 1981 and Johnson and Higgins, Funding Costs and Liabilities of Large Corporate Pension Plans, 1980. Results reported above are of a similar order of magnitude to those reported in these studies.

of the large corporate plans sampled in two recent studies had unfunded vested liabilities under 20 percent of the sponsor's net worth (Table II-3). In the event of plan termination the benefits in these plans would have been secure without imposing any liability on the PBGC.

Surveys conducted by Greenwich Research Associates (GRA) show that large plans have been fairly stable over time. The average actuarial liability in plans representing over 75 per cent of total defined-benefit plan assets has increased at roughly the same rate as total assets over the last seven years. Average plan liabilities—both vested and unvested—among the firms sampled were 81 percent funded in 1981 (Table II-4). This represents an increase over the previous periods which could be due in large part to stock market advance and interest-rate increases in 1981.

TABLE II-3.—UNFUNDED VESTED LIABILITIES AS PERCENT OF SPONSOR'S NET WORTH IN 2 SAMPLES OF LARGE CORPORATE PLANS, 1979-80

[In percents]

Unfunded vested liabilities as percent of sponsor's net worth	Percent of plans	
	Johnson and Higgins ¹	ICF study
(None)	28	54
Less than 10 percent.....	78	91
Less than 20 percent.....	91	95
Less than 30 percent.....	95	(²)
Number of firms sampled.....	293	215

¹ Sample drawn from the Fortune 500 companies.

² In this sample, 5.6 percent of the firms had unfunded vested liabilities greater than 20 percent, but no breakdown of data for those above 20 percent was reported.

Sources: ICF, Inc., "Background Data on Funding Status, Costs and Liabilities of Pension Plans, 1979-80," April 1981 and Johnson and Higgins, Inc., Funding Costs and Liabilities of Large Corporate Pension Plans, 1977-80.

TABLE II-4.—TRENDS IN AVERAGE ACTUARIAL LIABILITIES AND ASSETS OF LARGE CORPORATE PLANS, 1975-81

[Dollar amounts in millions]

Year:	Average projected actuarial liabilities ¹	Average percent funded	Corporations sampled
1975.....	\$160.3	70	768
1976.....	210.6	65	773
1977.....	184.0	66	933
1978.....	181.0	65	1,000
1979.....	251.0	65	1,081
1980.....	285.1	71	1,073
1981.....	368.1	81	1,074

¹ Includes vested and unvested liabilities.

Source: Greenwich Research Associates, Report on Large, Corporate Pension Plans (1976-82).

Smaller single-employer plans

While less information is available on smaller plans than on larger plans, smaller defined-benefit plans have more assets relative to liabilities than larger plans. Approximately two-thirds of 834 small and medium-sized defined benefit plans sampled in a recent study by the American Society of Pension Actuaries could fully meet their vested pension obligations out of plan assets (Table II-5). The sampled plans with the lowest values of assets as a percentage of vested liabilities were generally newer plans that provided retroactive credit for service with the employer prior to plan inception. These plans would not yet approach the funding status of more mature plans.

TABLE II-5.—PERCENT DISTRIBUTION OF SMALLER SINGLE-EMPLOYER PENSION PLANS BY FUNDING RATIO

Funding ratio	Number of participants				
	1-10	11-25	26-100	101-499 ¹	500-999 ¹
50 percent or more.....	93	89	96	84	86
75 percent or more.....	80	78	89	65	68
100 percent or more.....	67	60	66	45	46
Number of plans in sample.....	618	213	106	7,139	1,783

¹ See notes in table II-2.

Source: Data on plans with fewer than 100 participants from American Society of Pension Actuaries, "Analysis of Characteristics of Small and Medium Size Employer Sponsored Private Retirement Plans," Report to the President's Commission on Pension Policy, 1980. Data on plans with more than 100 participants from IRS data; EBRI tabulations.

While the smaller plans studied are, in general, better funded than larger plans, this may be because small employers make higher pension contributions. Pension costs as a percentage of wages and salaries are about 7 percent for the average Fortune 500 firm for which data are available, but some smaller plans involve pension costs as high as 37 percent of wage and salary costs (Table II-6).

TABLE II-6.—Pension costs as a percent of wages and salaries by plan size, various years

[Number of participants and pension contributions as a percentage of labor costs]	
1-10.....	37
11-25.....	14
26-100.....	12
101-500.....	7
Fortune 500 firms.....	7

Sources: Fortune 500 data from Johnson and Higgins; data for smaller plans from American Society of Pension Actuaries, "Analysis of Characteristics of Small and Medium Size Employer Sponsored Private Retirement Plans," Report to the President's Commission on Pension Policy, 1980.

Multiemployer plans

In general, multiemployer plans are not as well-funded as either larger or smaller single-employer plans but this may be due in large part to their use of more conservative actuarial assumptions to guard against fluctuations in contributions due to cyclical downturns. Much like single-employer plans, 80 percent of all multiemployer plans had 50 percent or more of vested liabilities funded with current plan assets (Table II-7).³ This proportion closely resembles single-employer funding. Over a quarter of multiemployer plans are fully-funded, however, compared to nearly half of larger single-employer plans and more than half of smaller single-employer plans (Table II-8).

TABLE II-7.—PERCENT DISTRIBUTION OF MULTIEMPLOYER PLANS BY SIZE AND FUNDING RATIO: 1977¹

Funding ratio	Plan size			
	Fewer than 1,000 participants	1,000 to 4,999 participants	5,000 or more participants	All sizes
25 percent or more.....	97	98	97	97
50 percent or more.....	84	76	77	80
75 percent or more.....	54	44	34	48
100 percent or more.....	34	22	19	28

³ These results show somewhat higher funding ratios than those reported in Pension Benefit Guaranty Corporation, Multiemployer Plan Termination Study, July 1978 (Attachment 9, app. XIII), based on a 1976 sample.

TABLE II-7.—PERCENT DISTRIBUTION OF MULTIEMPLOYER PLANS BY SIZE AND FUNDING RATIO:
1977¹—Continued

Funding ratio	Plan size			
	Fewer than 1,000 participants	1,000 to 4,999 participants	5,000 or more participants	All sizes
Number of plans.....	351	212	70	633

¹ See footnotes to table II-2.

Source: IRS disclosure data; EBRI tabulations.

TABLE II-8.—DISTRIBUTION OF PENSION PLANS BY FUNDING RATIO AND PLAN TYPE AND SIZE:
1977

Funding ratio ¹	Single-employer plans ²		More than 1,000 participants	Multiemployer plans ³
	Fewer than 100 participants	100-999 participants		
50 percent or more.....	92	84	80	80
75 percent or more.....	81	66	70	48
100 percent or more.....	65	45	47	28
Number of plans sampled.....	937	8,922	2,091	633

¹ Ratio of plan assets to total vested liabilities.² Weighted average based on data in table II-7.³ All sizes.

Source: Tables II-2, II-5, and II-7.

Why funding patterns vary

Funding patterns thus vary considerably by plan type and size. Multi-employer plans tend to have generally lower funding ratios than single-employer plans due to the special design features of multi-employer plans. First, many employers participating in multi-employer plans continue to view the negotiated contribution rate as the full extent of their funding obligation to the plans. Thus, benefits may increase even if contributions do not, since benefits and contributions are not jointly negotiated in most plans. As a result of ERISA and MEPPAA both beliefs and behavior have begun to change, however. Second, many multi-employer plans have unit benefit formulas, where pensions are based upon a fixed-dollar amount per year of service. ERISA currently does not allow the anticipation of increases in these benefits for funding purposes, even if there is a clear history of such increases. As a result, the accumulation of assets is frequently not as rapid in these plans as in plans where benefits are determined by other formulas. Third, multi-employer plans represent a kind of risk-sharing due to the involvement of many firms. Firms wishing to withdraw from multi-employer plans must pay the plan at least a portion of the money needed to fund unfunded vested liabilities.⁴ Small plans and large plans present a different set of funding contrasts and constraints. Small firms tend to be risky—numerous studies have documented their high failure rates. As a result of their greater business uncertainty, small employers may wish to fund their plans more rapidly to increase benefit security. Larger plans, in contrast, are sponsored by more stable firms, which reduces the need for more rapid funding.

A comparison of defined-benefit and defined-contribution plans

An average of nearly 26,000 net new defined-contribution plans were formed per year between 1971 and 1981, compared with an average of over 15,000 net new defined-benefit plans per year over this period.⁵ In 1981, moreover, new plan creation

⁴ As a result, many employers who have paid the contributions negotiated in their collective bargaining agreements are nevertheless being billed for withdrawal liabilities that in some cases exceed the net worth of their firms.

⁵ Treasury Department determination letters; totals compiled by EBRI from periodic news releases.

rates were over 20 percent higher than the highest growth levels recorded before the passage of ERISA. Defined-contribution plans outnumber defined-benefit plans by more than two to one. Due to the larger size of defined-benefit plans, however, they cover more than twice as many participants as do defined-contribution plans.⁶

Defined-contribution plans are smaller by most measures than defined-benefit plans. Assets in the median defined-contribution plan (\$44,900) are less than two-thirds the assets in the median defined-benefit plan (\$71,900)⁷. The faster rate of defined contribution plan formation, however, means that assets in defined-contribution plans are growing at a faster percentage rate (Table II-9). Defined-contribution plans nevertheless remain a relatively small component of total pension assets. Over 71 percent of total pension assets are held in defined-benefit plans, and net contributions to defined-contribution plans are less than half those to defined-benefit plans (Table II-9).

TABLE II-9.—NET CONTRIBUTIONS TO PENSION PLANS, 1977

(In billions of dollars and percents)

	Plan cash flow	Defined benefit	Defined contribution	Total
Contributions:				
Employer		29.6	11.0	40.6
Employee		.8	4.6	5.4
Subtotal		30.4	15.6	46.0
Investment income		12.1	7.1	19.2
Total income		42.5	22.7	65.2
Less:				
Benefits/annuity purchases		15.0	7.9	22.9
Expenses/other		1.0	2.2	3.2
Net contributions		26.5	12.6	39.1
Assets		229.4	90.4	319.8
Net contribution as percent of assets		11.6	13.9	12.2

Source: U.S. Department of Labor, Office of Pension and Welfare Benefit Plans, "Preliminary Estimates of Participant and Financial Characteristics of Private Pension Plans, 1977," (1981); EBRI calculations.

Newly-qualified defined contribution plans also have fewer participants—an average of 23—than defined-benefit plans, which have an average of 92 participants. Since the average defined-benefit plan has about four times as many participants as the average defined-contribution plan, therefore, most plan participants continue to be covered by defined-benefit plans despite their slower growth rates.

Two factors have contributed to recent increases in defined contribution plan formation. One is that smaller firms are increasingly establishing defined-contribution plans as the primary retirement plan for their workforces. Due to the greater financial uncertainty of these firms, many prefer such plans over defined-benefit pension plans, since the cost to the firm is known. Another factor contributing to defined-contribution plan growth is that firms with defined-benefit plans appear to be establishing supplemental profit-sharing or money-purchase plans as secondary plans. In 1977, 59 percent of all active pension-plan participants were employed by firms having both a defined benefit and a defined contribution plan.

PLAN TERMINATION AND BENEFIT GUARANTEES

Although the majority of private, single employer defined benefit plans appear to be relatively well-funded, plan terminations and insolvencies and hence claims against the PBGC will inevitably occur. A net claim represents the projected liability for guaranteed benefits less the value of plan assets and employer payments. Between 1974 and 1981 the PBGC single employer program experienced a total of 783 claims for \$345 million, of which over 47 percent arose from eight large plan terminations (Table II-10). The 53 plan terminations leading to claims between \$1 million and \$10 million accounted for more than a third of total claims. Although the aver-

⁶ The U.S. Department of Labor, Office of Pension and Welfare Benefit Plans, "Preliminary Estimates of Participant and Financial Characteristics of Private Pension Plans, 1977," 1981.

⁷ Ibid.

age number of claims per year has fluctuated, the average size of each claim has been stable, staying under \$1 million (Table II-11). Forty percent of the value of claims against the PBGC to date occurred in the last two years reported. Over 90 percent of the claims against the PBGC since its founding have arisen from sponsor insolvency, with the remainder resulting from the termination of plans by financially weak sponsors who recently acquired operating divisions from financially strong sponsors. Nevertheless PBGC claims arose in fewer than 3 percent of all terminations in 1980.

TABLE II-10.—PBGC SINGLE EMPLOYER CLAIMS EXPERIENCE, 1974-1981

[In millions of dollars]

Claim size	Number	Amount	Percent of total
Less than \$1,000,000.....	722	52.2	15.1
\$1 to 10,000,000.....	53	128.6	37.3
Over \$10,000,000.....	8	164.2	47.6
Total.....	783	345.0	100.0

Source: Pension Benefit Guaranty Corporation, Annual Report to the Congress, 1981, table 9.

TABLE II-11.—TRENDS IN PBGC SINGLE EMPLOYER CLAIMS, 1974-1980

[In millions of dollars]

	Number	Guaranteed benefit liabilities	Net claims	Average claim
Fiscal year:				
1975.....	98	58.9	34.5	0.35
1976.....	172	87.1	15.7	.09
1977.....	136	52.9	24.5	.18
1978.....	99	125.3	73.9	.75
1979.....	79	88.2	48.4	.61
1980.....	97	138.6	70.7	.73
1981.....	102	129.4	77.3	.75
Total.....	783	680.4	345.0	

Source: Pension Benefit Guaranty Corporation, Annual Report to the Congress, 1981, tables 5 and 6.

If the economy continues to decline, however, more firm failures will occur. Anticipating large increases in net claims, the PBGC has asked the Congress for a premium increase to cover both its current actuarial deficit and its expected financing needs. Policy issues surrounding this request as well as other changes in benefit guarantees currently being debated are discussed in Chapter V.

CURRENT STATUS OF STATE AND LOCAL GOVERNMENT PLANS

Unlike private-employer plans, public-sector pension plans are not required to meet uniform Federal funding and fiduciary requirements though state and local laws and professional standards do impose some obligations. Likewise, the benefits they provide are secured only by the funding status of the plans themselves and the financial capacity of the sponsoring government; Federal insurance does not cover public-sector plans.

Nearly half of state and local government pension plans report funding procedures consistent with those required of private plans under ERISA (Table II-12). The remainder use pay-as-you-go funding, or other funding approaches less stringent than ERISA. These data, however, must be interpreted in the light of budget practices and constraints common among state and local governments. Because there is no universally-accepted minimum funding standard for government plans, state and local governments sometimes use the pension funds to balance their budgets in periods of budget stringency (See Chapter V). On the basis of its survey, the House Pension Task Force estimated that such practices could act to reduce the pro-

portion of plans meeting ERISA soundness criteria from nearly half down to one-quarter or fewer of State and local plans.⁸

TABLE II-12.—FUNDING METHODS USED BY STATE AND LOCAL PLANS, 1976

Funding method used	State plans		Local plans		All plans	
	Number	Percent	Number	Percent ¹	Number	Percent
Pay-as-you-go.....	126	23	890	17	1,016	18
Advanced Funding Meeting ERISA ²	292	53	2,303	44	2,595	45
Not Meeting ERISA ²	110	20	1,727	33	1,837	32
Unknown.....	26	5	314	6	340	6
Total.....	554	100	5,234	100	5,788	100
Participants (in millions).....	10.4		2.1		12.5	

¹ Percents may not add to totals due to rounding.

² See text for explanation of these categories.

Source: EBRI calculations based on data presented in U.S. House of Representatives, Committee on Education and Labor, Pension Task Force Report on Public Employee Retirement Systems (95th Congress, 2d Session), Mar. 15, 1978.

Nevertheless, even though most plans do not meet ERISA standards, the benefits expected by most state and local retirement plan participants appear to be fairly secure if judged by prevailing funding standards. This is because most participants belong to a small number of very large plans. A recent study of the 100 plans covering 75 percent of all plan participants found that, depending on the adequacy standard used, these plans had assets ranging from 56 to 73 percent of vested benefits in 1980.⁹ The financial status of smaller plans is more mixed. Plans with 500 to 1000 participants appear to be fairly well-funded; many plans with fewer than 500 participants, however, do not make adequate contributions to achieve full funding within 40 years, which means they do not meet the ERISA soundness criterion.¹⁰

Total contributions as a percent of payroll, another measure of plan funding status, have been fairly stable, increasing from over 10 percent in 1960 and 1970 to over 13 percent in 1979 (Table II-13), in contrast with an average contribution rate in private plans of just over 7 percent in 1979 (Table II-6). Unlike private-sector plans, however, 85 percent of state and local government pension plans require employer contributions. Although the proportion of total contributions made by workers has declined over the last decade, workers contributed over one fourth of total contributions in 1979, down from 38 percent of total contributions in 1970 (Table II-14). Average contribution rates, however, would be higher if all state and local plans were funded in the same manner as private plans.

Another measure of state and local plan funding status is the ratio of plan assets to benefit payments, which is often used in the absence of actuarial data. It is widely believed that public plans should maintain a ratio of at least 10 to be considered minimally funded. Fewer than 16 percent of all state and local government plans with not quite 6 percent of all participants have a ratio of assets to benefits below six (Table II-15). These are primarily the smaller plans that are less well-funded. The majority of plans, accounting for the majority of participants, have an asset to benefit ratio in excess of 11. Hence, this measure, too, suggests that all but the smaller plans are fairly secure.

Some attempts have also been made to project the future status of State and local government plans. These projections are sensitive to underlying economic assumptions. A recent study conducted by the Urban Institute projected that pension costs as a percentage of payroll would decline from 12.7 percent in 1980 to approximately 8.6 percent by 2024 (Table I-16). If it is assumed that the level of employee contributions remains the same the employee share of contributions would rise from just over one-quarter of total contributions in 1980 to just over one-third of the total in 2024.

⁸ U.S. House of Representatives, Committee on Education and Labor, Pension Task Force on Public Employee Retirement Systems (95th Congress, 2nd Session), Mar. 15, 1978.

⁹ The Urban Institute and others, *The Future of State and Local Pensions*, Department of Housing and Urban Development Grant H-2921-RG, April, 1981.

¹⁰ Arden Hall and William D. Smith, *Local Public Employee Pension Plans Current Conditions and Prospects for the Future*, Department of Housing and Urban Development Grant H-5144RG.

TABLE II-16.—PROJECTED PENSION FLOWS AS PERCENT OF ANNUAL PAYROLL FOR LARGE STATE AND LOCAL RETIREMENT PLANS, 1980-2024

Pension Plan Flows	1980 (actual)	1989	1999	2024
Contributions:				
Employer.....	12.7	11.6	10.1	8.6
Employee.....	4.5	4.6	4.6	4.6
Earnings.....	10.7	14.9	17.4	17.4
Benefits.....	10.1	12.2	13.8	14.9
Increase in fund balance.....	17.8	18.9	18.3	15.7

Note.—Assumptions (in percent): Salary increases 6, Inflation 5, Investment returns 7, Unscheduled cost of living adjustments 0.

Source: The Urban Institute, *The Future of State and Local Pensions*, (Washington, D.C., 1981) table 18-5.

Under less optimistic economic assumptions, state and local plans mature more slowly. The General Accounting Office (GAO) has projected that by 2020, pension plan assets would be increasing at an annual rate of 9 percent rather than the 16 percent increase projected by the Urban Institute if less optimistic assumptions are used. (Table II-17). Adverse economic conditions as well as expenditure limitations prevalent among state and local governments could slow State and local pension-plan funding. Recent further developments in the funding of some individual state and local government plans are discussed in Chapter V.

TABLE II-17.—PROJECTED FUNDING PATTERNS FOR PUBLIC EMPLOYER PLANS, 1980-2020

(In billions of dollars)

Pension-plan flows	1980	1990	2000	2020
Contributions.....	24	68	170	851
Benefits.....	13	47	101	995
Assets.....	182	562	1,703	9,231
Percent increase in fund balance.....	14	11	12	9

Note.—Assumptions (in percents): Salary increases 7.2, Inflation 7.2, Investment returns 7.5, Cost-of-living adjustments 3.6.

Source: U.S. General Accounting Office, *An Actuarial and Economic Analysis of State and Local Government Pension Plans* (1980) p. 13.

CURRENT STATUS OF FEDERAL RETIREMENT PLANS

Ninety-five percent of Federal workers are covered by one of two retirement systems; the Civil Service Retirement System (CSRS) and the Military Retirement System (MRS).

The Civil Service System

The CSRS is funded by employee contributions, contributions from the employing agency, and general revenue funds from the Treasury. Each employee contributes 7 percent of his salary, (7.5 percent for Congressional employees choosing to participate) with an equal contribution from the employing agency. Since 1971 the Treasury has contributed an increasing proportion of the interest on the unfunded liability; currently, the Treasury pays all of the interest on the accrued unfunded liability. The Treasury also makes annual payments to the Civil Service Retirement Fund to amortize over a 30-year period any increase in the unfunded liability resulting from benefit improvements enacted after October 20, 1969. The net Treasury contribution to CSRS outlays in excess of employee and employing agency contributions is projected to be \$15 billion in fiscal year 1983. Asset accumulation in the Civil Service Retirement Fund has been increasing, more than doubling between 1975 and 1981 to \$84.4 billion. Nevertheless, CSRS actuaries estimate that the plan had \$469.5 billion in unfunded actuarial liabilities in 1980, making the plan 13.5 percent funded at the end of that year.

In 1981, contributions to the CRS reached 39.3 percent of payroll (Table II-18). While high compared with the private sector these rates are nevertheless lower than would be required if the plan were funded in accordance with ERISA. The Office of Personnel Management estimates that normal costs for the CSRS plan in 1977 (that is, the present value of the future benefits accruing during that year)

were approximately 36 percent of covered payroll. Amortizing existing unfunded liabilities over a 40-year period would increase pension costs to 83 percent of payroll in the first year, according to CSRS actuaries.

The Military Retirement System

The Military Retirement System (MRS) is funded solely on pay-as-you-go basis out of Federal appropriations. Federal MRS benefit payments were just under 46 percent of payroll in 1980 (Table II-19). Because there is no fund of assets and no employees contributions the entire amount of benefit payments comes from current Federal appropriations. Unlike Civil Service personnel, military personnel are also covered by the Social Security program during their time of service, and receive non-contributory credits for the imputed value of in-kind benefits included in compensation.

Military retirement costs as a percent of payroll have increased more than sixfold since 1960 (Table II-14). This is due to the large increase in the number of beneficiaries between 1970 (770,000) and 1980 (1.3 million), and because MRS benefits were fully indexed to the Consumer Price Index in 1962.

TABLE II-18.—CONTRIBUTIONS TO THE CIVIL SERVICE RETIREMENT SYSTEM, 1960-79

(Dollars in billions)

Year:	Contributions ¹	Estimated covered payroll	Contributions as percent of covered payroll
1960.....	\$1.5	\$12.0	12.0
1965.....	2.2	16.3	13.3
1970.....	3.7	26.3	14.2
1975.....	9.2	36.8	25.1
1976.....	10.7	38.6	27.7
1977.....	12.3	43.2	28.4
1978.....	14.2	47.8	31.6
1979.....	16.3	51.8	33.4
1980.....	19.2	51.2	37.5
1981.....	22.1	56.2	39.3

¹ Includes employee contribution and general revenue funds.

Source: appendix table A-2 and U.S. Bureau of the Census, Statistical Abstract of the United States, 1981. Covered payroll estimates are based upon unpublished data provided by CSRS.

TABLE II-19.—ANNUAL COSTS OF THE MILITARY RETIREMENT SYSTEM, 1960-79

(Dollars in billions)

Year:	Benefit payments	Annual payroll	Benefit payments as a percent of payroll
1960.....	\$0.7	\$9.3	7.5
1965.....	1.4	11.4	12.3
1970.....	2.9	19.4	14.9
1975.....	6.2	20.2	30.7
1980.....	11.9	26.0	45.8

Source: U.S. Bureau of the Census, Statistical Abstract of the United States, 1981, and unpublished data U.S. Department of Defense, Office of the Actuary.

Because military personnel meeting the 20-year minimum service requirement typically retire at a very young age (median retirement age was 39 in 1979) with fully-indexed benefits, funding the plan in accordance with ERISA standards would require much higher outlays than current financing procedures. On a current, or pay-as-you-go basis, the MRS required outlays equal to 59 percent of payroll in 1981. Had the outlays, however, also reflected amortization of \$431 billion in unfunded liability over 40 years as a level percent of payroll, MRS costs in 1981 would have been 97 percent of payroll (Table II-20).

TABLE II-20.—PROJECTED COSTS OF MILITARY RETIREMENT SYSTEM, 1981-2020

[Dollars in billions]

Year:	Estimated payroll	Total Accrual cost with 40 Yr amortization		Current costs	
		Amount	Percent of payroll	Amount	Percent of payroll
1981.....	\$23.5	\$22.8	97	\$13.9	59
1985.....	33.7	30.3	90	20.2	60
1990.....	44.5	39.6	89	27.6	62
2000.....	75.9	67.6	89	48.9	64
2010.....	128.9	116.0	90	80.1	62
2020.....	220.4	101.4	46	127.1	58
2030.....	376.4	173.1	46	207.9	55
2040.....	642.9	295.7	46	348.8	54

Source: Office of the Actuary, U.S. Department of Defense, "Valuation of the Military Retirement System," 1980, Tables VII, VIII, IX.

CURRENT STATUS OF SOCIAL SECURITY

The Social Security program pays retirement (OASI), disability (DI), and hospital (HI) benefits to eligible retirees, disabled persons, or dependents of eligible workers. Payroll tax collections are deposited in trust funds that operate to balance cash flow fluctuations, but do not accumulate significant assets.

The Social Security program covers over 90 percent of the private work force. Workers not covered include about 10 percent of the employees of nonprofit organizations, approximately 30 percent of the state and local government workforce, and approximately 90 percent of Federal civilian workers. Social Security is financed on a pay-as-you go basis through payroll taxes collected from both employees and employers on wages up to a maximum wage base. During 1982, employers and employees each will contribute 6.7 percent of the first \$32,400 of earnings for each covered worker.

The Social Security program faces financing problems in both the short and the long-run. The short-run problems are due primarily to recent trends in the performance of the economy; the long-run problems stem from demographic trends.

Short-run problems

The Social Security program's short-run problems stem both from recent cost increasing modifications to the program and from the recent adverse performance of the economy.

The Social Security program was modified several times during the 1970s to provide more generous benefits to retirees. Congress increased OASDI benefits by 15 percent in 1971 and 20 percent in 1972. In addition, the 1972 benefit changes incorporated a provision for adjusting existing benefits for annual changes in the cost of living, as measured by the Consumer Price Index (CPI), as well as indexing the benefit formula for inflation. Adding these two factors to large increases in nominal wages meant that benefits were over-indexed for inflation. As a result, the average proportion of a worker's preretirement earnings replaced by Social Security rose from between 30 and 40 percent in the 1950s and 1960s to over 50 percent in the 1970s and early 1980s.

In 1977, the Congress revised the benefit formula to eliminate what was, in effect, double indexing of benefits and to increase payroll taxes. The performance of the economy, however, has continued to create financing problems. Inflation and unemployment consistently exceeded the levels assumed for them at the time Congress considered changes in the program. Productivity growth has been lower than expected, resulting, in turn, in lower real wage growth than assumed.

As a result, real benefit levels have grown more rapidly than real wages, and the gap between them has widened over time. For example, the 1972 Report of the Social Security trust fund trustees projected that between 1972 and 1976 the CPI would rise an average of 2.8 percent a year and real wages would rise 2.3 percent a year (Table II-21). Were this forecast to have come true, trust fund balances would have been eroded somewhat, but not as much as they actually were. The CPI actually rose an average of 7.1 percent. While the 1977 Trustees' report was somewhat more

pessimistic in its projections for the 1977 to 1981 period, experience shows that it, too, was overly optimistic (Table II-21).

TABLE II-21.—A COMPARISON OF 5-YEAR ECONOMIC ASSUMPTIONS IN THE 1972 AND 1977 OASDI TRUSTEES' REPORTS WITH ACTUAL EXPERIENCE

	(In percents)					
	CPI increase		Real wage increase		Unemployment rate	
	Assumed ¹	Actual	Assumed ¹	Actual ²	Assumed ¹	Actual
1972 trustees' report:						
1972.....	2.8	3.3	2.3	5.7	4.2	5.6
1973.....	2.8	6.2	2.3	4.1	4.2	4.9
1974.....	2.8	11.0	2.2	-1.9	4.2	5.6
1975.....	2.8	9.1	2.3	-3.5	4.2	8.5
1976.....	2.8	5.8	2.3	4.3	4.2	7.7
1972-76 Total.....	14.53	40.6	11.77	1.0	4.2	6.5
1977 trustees' report:						
1977.....	6.0	6.5	2.4	1.5	7.1	7.1
1978.....	5.4	7.7	2.7	.6	6.3	6.1
1979.....	4.3	11.3	2.5	-2.6	5.7	5.8
1980.....	4.7	13.5	2.4	-4.9	5.2	7.1
1981.....	4.1	10.4	2.3	-1.5	5.0	7.6
1977-81 Total.....	28.2	60.0	12.9	-6.9	5.9	6.7

¹ Midrange assumptions.

² Estimates from the 1982 trustees report for all years beyond 1976.

Source: Assumptions from Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds, 1972 and 1977; actual experience from 1982 Economic Report of the President; real wage calculations by EBRI.

Long-run financing problems

The system's long-run financing prospects depend on demographic trends. Three trends have created potential financial problems.

Declining fertility rates.—The total fertility rate has declined from a rate of 3.8 children per woman in 1957 to 1.8 in 1980. This reduces the size of future workforce relative to retirees available to finance Social Security benefits, and therefore endangers the system's long-run actuarial balance.

Declining mortality rates.—Another important demographic change has been the increase in life expectancy during the last decade. The life expectancy at age 65 increased by more than one year for men and nearly two years for women between 1970 and 1980 (Table II-22). Current prospects suggest that life expectancy will continue to increase. Longer life expectancy increases Social Security costs since retirement benefits must be paid longer. At the same time, however, older workers may choose to work longer if medical advances allow them to stay healthy longer.

TABLE II-22.—LIFE EXPECTANCY AT AGE 65

Year:	(In years)	
	Males	Females
1960.....	12.8	15.8
1965.....	12.9	16.2
1970.....	13.1	17.0
1975.....	13.7	18.0
1980.....	14.2	18.8

Source: Social Security Administration, "U.S. Population Projections for OASDI cost Estimates, 1980," June 1980, table 15.

Increasing early retirement.—An increasing proportion of men are electing to retire prior to age 65 (Table II-23). Through 1970, labor force participation rates for men under age 65 declined only slowly. After 1970, however, labor force participa-

tion rates for men dropped significantly. Earlier retirement can increase the cost of retirees' benefits, but actuarial benefit reductions are imposed under Social Security and do reflect the retiree's longer expected period of reciprocity.

Social Security Trust Fund projections

Under current law, Social Security trust fund balances on hand may be insufficient to pay benefits on schedule by the mid-1980s, and the fund balances themselves are likely to become negative by the late 1980s (Table II-24). Available policy options and recent initiatives are discussed in Chapter V.

TABLE II-23.--LABOR FORCE PARTICIPATION FOR MEN, 1950-80

(in percent)				
Age group	1950	1960	1970	1980
55-59.....	87	88	90	83
60-64.....	79	78	75	61
65 and over.....	39	29	27	20

Source: U.S. Bureau of Labor Statistics, Employment and Earnings, January, 1971, January, 1979, January 1981, and U.S. Bureau of the Census, Census of Population 1960: Detailed Characteristics.

TABLE II-24.—COMBINED OASDHI INCOME OUTLAYS, AND TRUST FUND BALANCE PROJECTIONS, CALENDAR YEARS 1982 TO 1990 ¹

(in billions)				
Year:	Income	Outlays	Net Change in fund balances	Fund balances at end of year
1982.....	197.5	197.4	.1	40.2
1983.....	220.0	222.3	-2.3	37.9
1984.....	242.5	249.5	-7.0	31.0
1985.....	279.3	279.1	.2	31.2
1986.....	309.2	309.6	-.5	30.7
1987.....	335.0	341.1	6.1	24.6
1988.....	359.9	373.0	13.1	11.5
1989.....	384.0	404.1	-20.1	-8.6
1990.....	436.9	436.4	.5	-8.1

¹ Alternative II-B Assumptions.

Source: National Commission on Social Security Reform Staff Memorandum, February 25, 1982.

CONCLUSION

In summary, the condition of private and public-sector retirement programs differs considerably. Private-sector pension funds, are, as a whole, the best-funded set of programs, but not uniformly. It appears that multiemployer plans have lower asset holdings relative to their benefit obligations than both larger and smaller single-employer plans. Smaller single-employer plans, in turn, appear to be better-funded than larger plans.

Public sector plans are more difficult to study because there are no comprehensive public-sector reporting and disclosure requirements comparable to those imposed on private plans under ERISA. Available evidence, however, suggests that the few large plans that account for the majority of participants are fairly sound according to generally-accepted measures of funding status. Smaller public plans, much larger in numbers, are considerably less secure.

Federally-funded retirement plans present the greatest problems in funding status evaluation. Measures of funding status used to evaluate private and even state and local government plans are not necessarily relevant to Federal plans, largely because Federal plans are structured differently. Rather, the funding status of Federal programs depends more on budget priorities, overall economic policy, and the political consensus to benefit one social group by taxing another. The growing costs of these programs are threatening this consensus and numerous legislative initiatives have been introduced or suggested budgetary control over these programs.

Chairman RANGEL. We have another panel, the ERISA Industry Committee, George Pantos and Mark Ugoretz, executive director. Then we have representatives from the U.S. Chamber of Commerce, Lawrence Franklin, George Buck Consultants, and Michael Romig, director of the Employee Benefits Policy Center, and also on this panel will be the National Association of Manufacturers, Thomas Boyd, vice president of pension operations, from the Equitable Life Assurance Society of the United States.

I suspect this panel has been working very closely to try to find some solution to the problem that is before this committee, and I do hope that you can summarize your testimony and emphasize the differences that you would have with the proposal that was supported by the administration.

I suspect in principle and concept that all of you agree that something has to be done. However, where you differ from what has been proposed, it would be very helpful that you show not only what you disagree with but also what you would want to see done in lieu of that, especially as it relates to the reforms, since I suspect there is no difference of opinion as to the \$7 premium, is there, with anyone?

Mr. PANTOS. Yes, sir.

Chairman RANGEL. OK. Well, you have no restriction, but I certainly hope that you concentrate on the differences rather than just repeat the problem. Thank you.

George Pantos.

STATEMENT OF GEORGE J. PANTOS, COUNSEL, ERISA INDUSTRY COMMITTEE, ACCOMPANIED BY MARK UGORETZ, EXECUTIVE DIRECTOR

Mr. PANTOS. Thank you, Mr. Chairman. We are pleased to share our views with the subcommittee today on the financial status of the PBGC and on certain of the problems which have developed in recent years on the basic structure of the single employer termination insurance program.

Title 4 of ERISA was enacted into law in 1974 and established the PBGC as a nonprofit corporation which has three principal purposes: first, to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants; second, to assure the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which the title applies; and third, to maintain premiums established by the corporation in accordance with the statute at the lowest level consistent with carrying out its obligations under law.

The proposal that is pending before you to increase premiums to \$7 for the single employer program raises the question of whether the premiums are in fact being contained at the lowest possible level. ERIC has a substantial interest in the level of premiums, since major employee benefit plan sponsors such as those represented by ERIC pay 85 percent of all premiums collected.

Problems that have arisen involving the basic structure of the single employer program which impact on the PBGC premium have really developed within recent years. You may recall in late 1977 when this issue was before the Congress. A proposal was made

to increase the premium from the original \$1 level to the present \$2.60 level.

Fundamental problems of design which were incorporated in the original statute were only beginning to surface in 1977. Accordingly, neither the Congress, the administering agency, or the community of plan sponsors were able to effectively suggest solutions to those problems at that time. In particular, the employer community supported the proposal to increase premiums to the level required for the program.

I submit that the present situation is dramatically different. Substantial problems with the design of the single employer program have been identified by the PBGC and by much of the employer community. Accordingly, we believe it would be inappropriate to give attention only to a premium increase while at the same time ignoring the corresponding problems of the single employer program.

These design problems have, we believe, resulted in a greater than necessary burden on premium payers. A fivefold and greater increase in the premium requirement over a period of less than 10 years is truly significant and, we submit, merits close inspection. Continued skyrocketing of insurance premiums could threaten the viability of the insurance system, and could actually discourage rather than encourage the continuation and maintenance of voluntary private pension plans.

Thus, we submit there is a need for overall reform of the Title 4 program which would address these design flaws as well as the significant potential for abuse of the present insurance program.

Title 4 reform legislation which is pending in the Congress now, as has been indicated, H.R. 3930, before the House Education and Labor Committee, as well as the bill in the Senate, S. 1227, we believe, should focus on the following important policy objectives: financing of the current funding deficiencies and future obligations in the pension insurance system through a reasonable premium increase.

Second, adding safeguards to the current pension insurance system to prevent plan sponsors with low net worth from transferring significant unfunded liabilities to the PBGC directly through termination or indirectly through spinoffs and transfer of poorly funded pension plans.

Third, encouragement of plan sponsors through a rational termination mechanism to fund and deliver full vested benefits. And fourth, to permit under circumstances of demonstrable hardship relief for plan sponsors from the obligation to fund these benefits.

We have testified previously before the House Education and Labor Subcommittee on Labor Management Relations, chaired by Congressman Clay, on the need to reform the entire title 4 program. We continue to believe it is presently too easy for single employer plan sponsors voluntarily to end their obligations to fund defined benefit pension plans by terminating insufficiently funded plans and shifting their financial obligations to the PBGC, and thus onto other employers who are paying premiums to the termination insurance program.

Under present law, PBGC premium dollars are available to fund those guaranteed benefits not provided through plan assets and

employer liability even if the terminating plan sponsor remains profitable and continues in business. Many employers have already found this loophole and the potential for continued abuse of the present law, we believe, poses a serious threat to the already precarious financial position of the title 4 program.

Thus, we believe that the adoption of remedial provisions to address these current problems of the termination insurance program such as those contained in H.R. 3930 is of paramount importance.

Now, while we do not support all of the provisions of H.R. 3930 as currently drafted, we do not believe that any premium increase should be considered by Congress except as a component of a plan to correct the major title 4 deficiencies in ERISA that have been identified, and preferably with other changes to assure a sounder and stronger private pension system for our Nation.

Now, while differing on some of the specifics in pending legislation, we strongly support the overall approach adopted in H.R. 3930 to overcome present deficits in the title 4 program. This bill would establish substantial safeguards for the program while continuing to offer employers an opportunity to terminate their plans under appropriate conditions without any reduction in the protection currently afforded to plan beneficiaries.

We believe the approach proposed in H.R. 3930 will be effective to tighten up the present law by limiting the opportunity for plan sponsors to transfer insufficiently funded pension plans onto the PBGC except in the most compelling circumstances.

We wholeheartedly endorse the concept that only when plan sponsors are experiencing substantial economic distress should they be permitted to terminate a pension plan and the PBGC then be required to assume the obligation to pay guaranteed benefits through the pension insurance system.

Since this Act has severe consequences upon plan participants, namely a cutback to guaranteed benefits rather than vested benefits, it should be permitted only in those circumstances of dire distress as described in H.R. 3930. We also agree that an ongoing employer who terminates a plan, and the key word there is "ongoing employer," under these circumstances should be liable for the full unfunded guaranteed benefits.

In addition to being able to collect up to 30 percent of the employer's net worth, the PBGC should receive a future profits interest for any remaining unfunded guaranteed benefits which have been paid for a period certain, such as the 10-year period suggested in the bill.

We believe the specific criteria for trust termination are appropriate and represent a significant improvement to the title 4 program. At the same time, we believe it is essential to retain the flexibility necessary to encourage the continued growth of the private pension system while increasing the likelihood that benefits will be paid by the plan in all but the most compelling circumstances.

Since the plan sponsor carries the primary obligation to properly fund and deliver benefits as promised to participants, Government policy should encourage the attainment of this goal.

We are therefore particularly pleased that H.R. 3930 would permit an employer to terminate a pension plan subject to contrac-

tual obligations arising through collective bargaining agreements with the least possible interference from Government. The so-called standard termination procedure is a creative solution to PBGC's current problem, and, I might add, one that relies on the private sector.

H.R. 3930 contains provisions that would impose contingent liability on an employer who shifts unfunded liabilities to the FBGC indirectly by the transfer of control of a plan prior to plan termination to another business entity outside the control group. Such transfers are effected through sales of businesses, spinoffs, and business reorganizations.

Under present law, liability to the PBGC for unfunded guaranteed benefits is attributable only to the employer maintaining the plan on the date of the plan termination. To discourage the dumping of such unfunded pension obligations on financially weak entities, H.R. 3930 would impose contingent liability on a transferor for a 5-year period following the date of the transfer where such liability is applicable.

We endorse this 5-year period of contingent liability and generally support the safe harbors incorporated in the bill to eliminate contingent liability if it is not necessary or where the liability is de minimis.

In conclusion, Mr. Chairman, the proposal to increase the annual PBGC premium to \$7 is of great concern to plan sponsors. However, we are encouraged that the design changes in the single employer program which have been identified will contribute greatly to keeping future premiums at the lowest possible level.

Under these circumstances, we would support a reasonable premium increase as part of the legislation which has been developed to reform the single employer insurance program.

Thank you, sir.

[The prepared statement follows:]

STATEMENT OF GEORGE J. PANTOS, ON BEHALF OF THE ERISA INDUSTRY COMMITTEE ("ERIC") ON THE FINANCIAL STATUS OF THE PBGC'S SINGLE EMPLOYER INSURANCE PROGRAM

My name is George J. Pantos. I am a partner in the law firm of Vedder, Price, Kaufman, Kammholz & Day, and I serve as counsel to the ERISA Industry Committee.

ERIC is an association of over 100 major corporations concerned with national retirement policy issues. ERIC's members include approximately half of the nation's fifty largest industrial companies and represent a broad cross-section of the nation's largest retailers, utilities, bankers and insurers.

We are pleased to share our views with the Subcommittee today on the financial status of the Pension Benefit Guaranty Corporation and on certain problems which have developed in recent years on the basic structure of the single employer termination insurance program.

Title IV of ERISA established the PBGC in 1974 as a non-profit corporation whose purpose is—

- (1) to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants,
- (2) to assure the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which the title applies, and
- (3) to maintain premiums established by the corporation in accordance with the statute at the lowest level consistent with carrying out its obligations under law.

The proposal to increase premiums to \$7.00 for the single employer program raises the question of whether premiums are, in fact, being contained at the "lowest level." ERIC has a substantial interest in the level of premiums since major plan

sponsors, such as those represented in ERIC, pay 85% of all premiums collected. Problems involving the basic structure of the single-employer insurance program which impact on the PBGC premium have developed in recent years. When, in late 1977, a proposal was made to increase premiums from the original \$1 level to the present \$2.60 level, fundamental design problems were only beginning to surface. Accordingly, neither the Congress, the administering agency, or the community of plan sponsors were able to effectively suggest solutions to those problems at that time. In particular, the employer community supported the proposal to increase premiums to the level required for the program.

The present situation is dramatically different. Substantial problems with the design of the single-employer program have been identified by the PBGC and by much of the employer community. Accordingly, we believe it would be inappropriate to give attention only to a premium increase, while at the same time ignoring the corresponding problems of the single-employer program.

These design problems have, we believe, resulted in a greater than necessary burden on premium payers. A five-fold increase in the premium requirement over a period of less than 10 years is truly significant and merits inspection. Continued skyrocketing of insurance premiums could threaten the viability of the insurance system and could actually discourage, rather than encourage the continuation and maintenance of voluntary private pension plans. Thus, there is a need for overall reform of Title IV program which would address the design flaws as well as the significant potential for abuse of the present insurance system.

Title IV reform legislation should focus on the following policy objectives:

(1) Financing of current funding deficiencies and future obligations in the pension insurance system through a reasonable premium increase;

(2) Adding safeguards to the current pension insurance system to prevent plan sponsors with low net worth from transferring significant unfunded liabilities to the PBGC directly through termination or indirectly through spinoffs and transfer of poorly-funded pension plans;

(3) Encouragement of plan sponsors through a rational termination mechanism to fund and deliver full vested benefits, and;

(4) To permit, under circumstances of demonstrable hardship, relief for plan sponsors from the obligation to fund these benefits.

ERIC has testified previously before the House Education and Labor Subcommittee on Labor-Management Relations on the need for reform of the Title IV program. We continue to believe it is presently too easy for single employer plan sponsors voluntarily to end their obligation to fund defined benefit pension plans by terminating insufficiently funded plans and shifting their financial obligations to the PBGC—and thus onto other employers who are paying premiums to the termination insurance program.

Under present law, PBGC premium dollars are available to fund those guaranteed benefits not provided through plan assets and employer liability, even if the terminating plan sponsor remains profitable and continues in business. Many employers have already found this loophole and the potential for continued abuse of the present law poses a serious threat to the already precarious financial condition of the Title IV program. Thus, we believe that the adoption of remedial provisions to address these current problems of the termination insurance system, such as those contained in H.R. 3930, is of paramount importance.

While we do not support all provisions of H.R. 3930 as currently drafted, we do not believe that any premium increase should be considered by Congress except as a component of a plan to correct the major Title IV deficiencies in ERISA that have been identified, and preferable with other changes to assure a sounder and stronger private pension system for our nation.

DISTRESS TERMINATION

We strongly support the overall approach adopted in H.R. 3930 to overcome present deficits in the Title IV program. This bill would establish substantial safeguards for the program while continuing to offer employers an opportunity to terminate their plans under appropriate conditions, without any reduction in the protection currently afforded plan beneficiaries. We believe the approach proposed in H.R. 3930 will be effective to tighten up the present law by limiting the opportunity for plan sponsors to transfer insufficiently funded pension plans onto the PBGC—except in the most compelling circumstances.

We whole heartedly endorse the concept that only when plan sponsors are experiencing substantial economic distress should they be permitted to terminate a pension plan and the PBGC be required to assume the obligation to pay guaranteed

benefits through the pension insurance system. Since this act has severe consequences upon plan participants, namely a cutback to guaranteed benefits, it should be permitted only in these circumstances of dire distress as described in H.R. 3930. We also agree that an ongoing employer who terminates a plan under these circumstances should be liable for the full unfunded guaranteed benefits. In addition to being able to collect up to 30 percent of the employer's net worth, the PBGC should receive a future profits interest for any remaining unfunded guaranteed benefits which have been paid for a period certain such as the 10-year period suggested in the bill. We believe the specific criteria for a distress termination are appropriate and represent a significant improvement to the Title IV program.

However, we must point out that the additional 5 percent profit pre-tax contribution to a new termination trust is a troublesome expansion of employer obligations. We question whether this provision is necessary or appropriate to cure the existing problems confronting PBGC. As currently drafted, it will be difficult to administer.

STANDARD TERMINATION

At the same time, we believe it is essential to retain the flexibility necessary to encourage the continued growth of the private pension system while increasing the likelihood that benefits will be paid by the plan in all but the most compelling situations.

Since the plan sponsor carries the primary obligation to properly fund and deliver benefits as promised to participants, government policy should encourage the attainment of this goal. We are, therefore, particularly pleased that H.R. 3930 would permit an employer to terminate a pension plan, subject to contractual obligations arising through collective bargaining agreements, with the least possible interference from government. The so-called "standard termination" procedure is a creative solution to PBGC's current problem, and I might add, one that relies on the private sector.

Under this proposal, the PBGC would assume no obligation to pay guaranteed benefits and the plan sponsor would not be required to obtain PBGC approval. This approach would provide needed flexibility for plan sponsors while retaining necessary safeguards for the PBGC in the role as insurer of last resort. However, the language in H.R. 3930 concerning collective bargaining relationships is overly broad. As presently drafted, the role prescribed for the bargaining agent extends well beyond the bounds of the interests established in the bargaining agreement. This comment is equally applicable for both the standard and distress termination provisions of the bill.

TRANSFER LIABILITY

H.R. 3930 contains provisions that would impose contingent liability on an employer who shifts unfunded liabilities to the PBGC indirectly by the transfer of control of a plan prior to plan termination to another business entity outside the control group. Such transfers are effected through sales of businesses, spinoffs and business reorganizations. Under present law, liability to the PBGC for unfunded guaranteed benefits is attributable only to the employer maintaining the plan on the date of the plan termination.

To discourage the dumping of such unfunded pension obligations on financially weak entities, H.R. 3930 would impose contingent liability on a transferor for a 5-year period following the date of the transfer where such liability is applicable. We endorse this 5-year period of contingent liability and generally support the "safe harbors" incorporated in the bill to eliminate contingent liability where it is not necessary or where the liability is "de minimis."

* * * * *

In conclusion, the proposal to increase the annual PBGC premium to \$7.00 is of great concern to plan sponsors. However, we are encouraged that the design changes in the single employer program which have been identified will contribute greatly to keeping future premiums at the lowest possible level. Under these circumstances, we would support a reasonable premium increase as part of the legislation which has been developed to reform the single-employer insurance program.

Chairman RANGEL. I want to move on with the panel but, you know, this is the tax writing committee, and I just would ask that assuming that you were persuasive in Education and Labor Committee, would you support the \$7 premium?

Mr. PANTOS. We testified originally on the premium, Mr. Chairman, at the \$6 level, and we found great difficulty in agreeing with many of the concepts upon which the \$6 premium was grounded. At the time when the \$6 premium was proposed, there were problems that we had in terms of the PBGC's assumptions on amortization. Their original approach was an amortization of 5 years. This one has been changed to 15 years.

Chairman RANGEL. I am having difficulty in finding out what your position is except that you agree with the concept, that you know that there has to be an increase in premium, and that you have some problems with the reforms. But I am just assuming. Have you drafted any legislation proposals or amendments to existing legislation for your clients that would show us what you would want to see us do?

Mr. PANTOS. Mr. Chairman, we have participated actively in the process of the legislative development of H.R. 3930.

Chairman RANGEL. I know, but you still have reservations. Have you drafted anything to take care of the legislative reservations you have to the nontax portion of the bill?

Mr. PANTOS. Well, I might say, sir, at the present time the bill which is pending in the Senate, S. 1227, which represents a modification of H.R. 3930, comes a lot closer to the position supported by ERIC.

Chairman RANGEL. Do you support it?

Mr. UGORETZ. Mr. Chairman, I am Mark Ugoretz, executive director of the ERISA Industry Committee. We support the concept of Senate bill 1227 and House bill 3930. In all deference, however, both of these bills are now before our members, our task force, and they are presently considering them. We do believe, yes, that they will be affirmative in their support for practically all of the bill. At the moment, since I don't have an answer from them, it is difficult for us, and I apologize for not having a more complete answer for you.

Chairman RANGEL. That explains it. I appreciate it. We don't have an answer from other Members of Congress. But to say you support it in concept but it does not go far enough does not really give us the type of political courage that we like to have when we say that people have testified.

In any event, you are not going to put the \$7 premium before the membership, are you?

Mr. UGORETZ. They are currently considering it, and it is part of the package, certainly.

Chairman RANGEL. Well, we thank you for your contribution, and we do hope that you would share with us at some point what conclusions you have reached. If this is a crisis, we are all going to have to agree that everyone cannot be accommodated. We can try to accommodate as many people as we can, but everyone will not like every part of the bill. We hope you will be able to frame up a position on this, because this is a rough year for Members of Congress to be rescuing funds without having those that we are trying to help say thank you.

Mr. PANTOS. Mr. Chairman, if it might be helpful to you in response to the question, we did testify last year—I think it was in October—before the House Education and Labor Committee, and at

that time ERIC did take the position that we reluctantly supported the \$6 premium—

Chairman RANGEL. That is courageous enough for me, if I can get it this year.

Mr. PANTOS [continuing]. If it were linked with the changes that we were suggesting.

Chairman RANGEL. That is good enough. At least we know what the problems are, and even reluctant support is something for the record. However I can appreciate that you cannot do it until you check with your membership.

I am sorry to have interfered with the presentation of the testimony, but we are concerned as to what can be supported and what cannot be supported, and what recommendations the chamber and NAM are prepared to make. So forgive the interruption—you do not have any additional testimony, do you?

Mr. UGORETZ. No, sir, I do not. Thank you.

Chairman RANGEL. So let us hear from the chamber. Mr. Franklin?

STATEMENT OF LAWRENCE M. FRANKLIN, MANAGER, DALLAS OFFICE, GEORGE B. BUCK CONSULTANTS, ON BEHALF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY MICHAEL J. ROMIG, DIRECTOR, EMPLOYEE BENEFITS POLICY CENTER

Mr. FRANKLIN. Mr. Chairman, I have submitted my remarks in writing.

Chairman RANGEL. By unanimous consent, your full remarks will be in the record.

Mr. FRANKLIN. I would like to summarize and make one or two comments related to my remarks.

Chairman RANGEL. That will be helpful.

Mr. FRANKLIN. I manage the Dallas office of Buck Consultants. Prior to joining that firm, I directed the Office of Program Development at the PBGC and did supervise the premium study at the \$2.60 level.

The chamber is persuaded that PBGC's current financial condition is sufficiently poor to support a premium increase. Plan termination insurance is obviously a more expensive federal program than was envisioned when ERISA was passed 10 years ago. In supporting an increase in the premium, however, we would like to make it clear that we are troubled by the lack of solid analytical support for a premium as high as \$6 or \$7, certainly not for an extended number of years into the future.

The increase is needed primarily to amortize losses incurred during the recent recession, not to build a war chest to cover claims for which the PBGC seems unable to identify any cause and effect relationship.

I might note that of the \$7, once you subtract \$1 for administrative expenses, \$4.50 is assumed to cover claims not yet incurred. These are claims to be incurred in the next 15 years. They talked a lot about bad experience in the past, but only \$1.50 of that premium is intended to cover that bad experience; \$4.50 is intended to go

for projections that we really have trouble buying, with the paucity of data we have been given.

Mr. GIBBONS. Go back over that math again. Let me see if I understand this.

Mr. FRANKLIN. According to the testimony submitted by Mr. Tharp, \$1.50 is to cover amortizing current claims; \$4.50 for future costs. I had not had time to analyze his statement. It appears they are assuming an 8 percent escalation in claims every year for the next 15 years.

Mr. GIBBONS. You are saying \$3.50 would take care of it?

Mr. FRANKLIN. \$4.50, I believe, is what Mr. Tharp suggested was expected future experience. \$1.50 would go for the retirement of the deficit, and we understand there is a deficit, and we are prepared to chip in for that. I do not know where the \$4.50 is coming from. Evidently he is suggesting that you have not seen anything yet in the way of claims.

Mr. GIBBONS. You are the fellow that did the last study. Is that right?

Mr. FRANKLIN. Yes, sir.

Mr. GIBBONS. I am not criticizing you. You are in a—

Mr. FRANKLIN. Part of this is the mathematics of compounding things for 15 years. When they first opened up the \$2,000 IRA's to everybody, there were some banks in New York that were saying if you put \$2,000 a year into an IRA at 12 percent for 30 years you would be a millionaire. The compounding effects for 15 years at 8 percent means that the claims would triple in 15 years. That means a program that is headed far out of control if it is not already, and that assumes the loopholes would be closed as well.

Mr. GIBBONS. You are saying a premium of \$4.10 is plenty. Is that right?

Mr. FRANKLIN. I have not put my own number. We are troubled by the lack of sufficient analytical information to know where the claims are coming from. We do not even know if the loopholes are going to create significant impact on the premium. I know a lot of people who do not think there is that much action in those loopholes. The big Braniff bankruptcies and the other ones are still going to occur under 3930.

Chairman RANGEL. What have you done? You knew where they were coming from, and you were the first to admit that the corporation is in trouble; so, you agree that something has to be done.

Mr. FRANKLIN. Something needs to be done.

Chairman RANGEL. But you just questioned the validity of some of the facts that they presented to us to reach the \$7 conclusion and to adequately protect employees in terms of closing the loopholes.

Mr. FRANKLIN. We believe that there is action in the loopholes both from a mental comfort with the program standpoint, and there is actually probably going to be some money there. We are not sure how much.

Chairman RANGEL. Well, why do you not have the same type resources available to you to help us out? Mr. Gibbons has suggested that we, and we may try to do it, get those people that are going to be affected by legislation to have their debates publicly, right here

in our committee, so that we can get the benefit of your vested interest concerns. That's healthy.

Mr. FRANKLIN. Mr. Chairman, we have even seen the Government's own accounting groups have a difficult time agreeing to what is the level of losses that the PBGC has incurred, let alone what has been the cause.

Chairman RANGEL. But you see, you cannot really have it both ways. You cannot say that you agree in concept, and then when we come up with an answer, then you go out and blast us for not being considerate of supporting business, which is the basis of our hopes for the economy in the future. If we go to business, you represent the National Association of Manufacturers, and say, we have a problem, what is your proposed resolution to that problem?

Mr. FRANKLIN. Yes, sir. We are prepared to support a premium increase at this time.

Chairman RANGEL. I know, but if we support \$7, then you will knock us for not agreeing to the recommended—

Mr. FRANKLIN. Sir, if the data shows it is \$7, we are prepared to support \$7. Seven is not a number that is going to break a lot of people's backs. It is a number that a lot of our small employers—

Chairman RANGEL. Well, I am having a little difficulty in trying to find out what people would agree on. This is particularly the case with the National Association of Manufacturers, who are extremely critical when legislation is proposed that they disagree with. I think that serves a healthy legislative function, but it also helps if we can avoid that criticism. The way you are leaving it now, we will not know, based on your testimony, what NAM would support.

Mr. FRANKLIN. Sir, I represent the chamber of commerce.

Chairman RANGEL. I am sorry. Well, same thing. It is really the same thing, except you have a TV program, and NAM does not have a TV program.

Mr. FRANKLIN. We are primarily composed of mostly smaller employers for whom the concept of this program is troublesome.

Chairman RANGEL. I am not trying to bind you this morning. I am saying that you would not appreciate your elected officials walking away from proposals that you were saying made a lot of sense. There is a problem. We agree with you on the problem. We just cannot agree on the solution.

Mr. FRANKLIN. I would suggest that those that are prepared to support an increase are perhaps more prepared to support one that is temporarily designed to eliminate a deficit and has less of the premium intended to cover claims that we do not know about, that have not come in yet. Premiums that we all dip into our pocket for the next 2 or 3 years to solve a problem, and then we drop down to some other nominal level are the structure of a premium change that would be more comfortable to those people that have to pay it than to know it was \$7 for the next 15 years.

Chairman RANGEL. We should act this year, no matter what we do, though?

Mr. FRANKLIN. Yes, sir.

Mr. PICKLE. Would the gentleman yield?

Chairman RANGEL. Yes, I certainly will.

Mr. PICKLE. In order to try to be more specific in the amount that we would recommend, you have stated that the premium should be raised beyond levels needed to eliminate the deficit, and then you add, and those accurately projected to rise in the next 3 years. Now, the premium that would take care of the deficit, as I understood you, was \$1.50?

Mr. FRANKLIN. That is what Mr. Tharp indicated would do it for the next 15 years.

Mr. PICKLE. Now, what do you think would be needed to take care of those accurately projected to rise over the next 3 years?

Mr. FRANKLIN. Maybe \$1.50 or \$2.

Mr. PICKLE. Well, let us say you are generous. In your generous moods you would say \$2. That would be \$3.50. So you are saying that in general your organization would think \$3.50 would be enough.

Mr. FRANKLIN. They do have to pay for the PBGC employees, and that takes \$1.

Mr. PICKLE. I did not hear you.

Mr. FRANKLIN. You do have to pay for the PBGC employees, and that takes \$1. So that would really be \$4.50. There are administrative expenses, I believe.

Mr. PICKLE. So your position generally would be a \$4.50 level as compared to the \$7 level?

Mr. FRANKLIN. Yes, sir.

Mr. ROMIG. Chairman Rangel, I would like to point out we discussed this at the chamber of commerce in January. We took the position that Mr. Franklin has announced, but also went one step further and said that we could if the evidence warrants support a premium increase as large as \$6, to a point of \$6. So that is our outside limit.

Chairman RANGEL. I think that is fair enough, if you drop the other shoe and say, this is the type of evidence that we will need even to reach that conclusion.

Mr. FRANKLIN. Yes, sir. We have asked for that and not received that kind of data.

Chairman RANGEL. Well, you present to us in some fashion what data you need; because if we are going to go to the mat over \$6 or \$7, that is no problem. But you know, your position of agreeing in concept that there should be a premium increase from \$2.60 to \$6 is still conditioned on the fact that they can establish need, isn't it?

Mr. ROMIG. It would seem to me that industry's position on the premium is fairly uniform, in that we all agree that an increase is needed, and most of us are ready to go as high as \$6, perhaps higher if the data warrants.

Chairman RANGEL. Well, why do you not get together, as I know you do, and prepare a questionnaire on what data you think that your clients would need, and send that to the Corporation, and a copy to the chairman of this subcommittee? At least we would know what your reservations are.

I do not mean to direct the testimony. You do the best you can by your clients, and we respect that, because you are the experts, and we certainly are not. But, we do like sometimes to walk away from listening to witnesses understanding what their positions are.

Mr. ROMIG. I would say there is another quid pro quo in the industry position that is fairly uniform, that we would very much like to correct some of the flaws in the program at the same time the premium increase goes through, because we believe if that train leaves the station and the reforms are not there, it will be a long time in coming before we ever have the opportunity.

Chairman RANGEL. I do not think that on the question of reforms or on the question of increase in premium we have any problems in concept. We do have a problem, however, as to what are the specific reforms that you would feel comfortable with, and how high should the premiums go.

Mr. FRANKLIN. We do not have any quarrel with the fact that PBGC has incurred losses greater than anticipated, and that something needs to be done to take care of those. I guess our concern is so much of the premium increase is really directed toward losses that we thought we would not have any more, and yet instead it appears their projections suggest that losses are going to get worse than they have been in the past, and yet much of the discussion of the GAO and PBGC was focusing on the past as the source of the reason they are in trouble, not the future.

Chairman RANGEL. Well, they are using some 8-year economic cycle. The General Accounting Office said they did not have any problem with the basis of their projection. So, what you have to do is show why you do have a problem with it, and how you would like to project it. We appreciate that we are asking you to pay the premium, and you understand that it is a deficit that has to be dealt with.

So we may not agree; but it would seem to me to make some sense for you to say this is how I would do it if I was running the Corporation. But to say that you agree in concept but you need more answers really isn't very helpful. Prepare the questions and we will attempt to get those answers. You can do it individually or collectively.

Mr. PANTOS. Mr. Chairman, may I just add one point?

The procedure in the past on the premium has been one in which the premium payers have participated in a dialog with the PBGC through the Congress because the Congress has the authority to approve the premium. There are not opportunities directly available under the statute for the premium payers to communicate with PBGC on the premium.

Chairman RANGEL. Well, if you could present to this subcommittee the questions and methodology that you are suggesting and the problems that you have with the data—

Mr. PANTOS. Primarily the problems are statistical approaches and forecasting theories.

Chairman RANGEL. You are not just going to knock theirs. You have got to come up with one that you could accept.

Mr. PANTOS. Yes, sir.

Mr. FRANKLIN. I have no other comments or remarks for the Chamber, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF LAWRENCE M. FRANKLIN, ON BEHALF OF THE CHAMBER OF COMMERCE
OF THE UNITED STATES

My name is Lawrence M. Franklin. I am a benefit consultant and manager of the Dallas office of George B. Buck Consulting Actuaries. I appear here today on behalf of the U.S. Chamber of Commerce where I am the chairman of the Pension Benefit Guaranty Corporation (PBGC) Task Force. This task force is responsible for formulating U.S. Chamber policy on the pension guaranty insurance programs and is a component of the Chamber's Employee Benefits Policy Committee.

Before joining Buck Consultants and becoming active with the U.S. Chamber's Employee Benefits Policy Committee, I was director of program development for the Pension Benefit Guaranty Corporation. While there, I was in charge of the Contingent Employer Liability Insurance (CELI) Task Force and the first request for a premium increase for the single employer guaranty program was based upon projects prepared by actuaries, financial analysts and economists who reported to me. I am not only knowledgeable about the procedures used by the PBGC in developing its projections, but I have closely followed the fortunes and misfortunes of the PBGC during the five years since I left the corporation.

SUMMARY

The Chamber's membership includes a significant percentage of the employers subject to the premium and pension termination requirements of Title IV of ERISA and administered by the PBGC. Many of our members have expressed concern about the pension guaranty insurance programs.

In responding to these concerns, our task force found that the PBGC's financial status has been deteriorating over the last several years. Liabilities have been accumulating faster than premiums can be collected to cover the unfunded pension obligations of terminated pension plans. Obviously, a premium increase will be necessary to close the deficit accrued to date. However, it is difficult for us to confirm the accuracy of the PBGC's projected future liabilities and we are yet to be persuaded by the arguments advanced by the PBGC in support of their projection.

Therefore, we are convinced that the premium should not be raised beyond levels needed to eliminate deficits accrued to date and those accurately projected to arise over the next 3 years. We also recommend that the premium increase be effective January 1, 1985.

Our investigation also uncovered serious flaws in the single employer program which we believe must be remedied and linked to any increase in the premium. However, after studying the House and Senate Labor Committee proposals to link these reforms to the premium request, we have several objections to the proposed reforms. We hope the Committee will recognize the problems and work with us to correct them so the premium increase and needed reforms can be swiftly enacted.

PBGC'S FINANCIAL STATUS

The PBGC, which administers both the single employer and the multiemployer pension guaranty insurance programs, has reported that its single employer program is incurring an ever increasing deficit that may total \$938 million by the end of FY 1987. To remedy this, the PBGC has requested an increase in the premium for the single employer program from \$2.60 per participant to \$7.00 per participant. The increase would become effective on January 1, 1984.

With about 100,000 defined benefit pension plans covering 30 million plan participants, this 170% increase in the premium is projected to reduce PBGC outlays by \$101 million in FY 84, \$154 million in FY 85, \$168 million in FY 86, and \$199 million for FY 87. This would cut the projected FY 87 unfunded liabilities of \$938 million by two-thirds and eliminate the deficit a few years later.

There is no secret about what is causing the growing deficit. More and more pension plans are being terminated with assets insufficient to meet guaranteed pension payments and these are accumulating faster than the PBGC can collect premiums to cover the shortfall.

But there is more to the premium request than just growing deficits. Many questions need to be answered and the PBGC has been less than candid about many of them. Here are some of the questions being raised and the answers we think are appropriate.

How accurate is the deficit forecast?

Since its inception the PBGC has been hampered by recurring accounting and internal control problems that have prevented the General Accounting Office (GAO)

from issuing a certificate of approval in connection with its required audit. Despite efforts by the PBGC to correct these weaknesses, the GAO was unwilling, in its FY83 reports, to certify PBGC statements. Therefore, the deficit forecasts of the PBGC are, in our opinion, unreliable.

It should also be noted that there are some other questionable features about the PBGC deficit projection. It assumes that (1) the recent claims history can be projected into the future and (2) the growth rate for past claims can also be projected to continue. In a word, PBGC is saying, "We ain't seen nothing to compare with what's ahead." Ironically, while the PBGC makes these arguments, it admits that it has been unable to link its volume of claims to any barometer of economic activity! Just what are we to believe about the PBGC's representations?

When ERISA was enacted, plan terminations greatly exceeded the number of plan formations as IRS records clearly demonstrated. Many of these plans were underfunded and their sponsors found that plan terminations requirements were less costly than compliance with the numerous provisions of ERISA. More recent IRS data reveal that plan formations now exceed plan termination applications. We believe that using the early years of PBGC's history will tend to overstate future liabilities.

The period being used by the PBGC for its deficit projection also happened to be a period of low economic activity, poor stock market performance and record levels of corporate bankruptcies. By 1983, the rebounding stock market had produced 30 percent increases in the asset values of most plans. This means that the risk exposure of the PBGC had been reduced by that amount. Moreover, the robust economic situation has curbed the number of corporate bankruptcies—which all agree is the leading cause for the increase in the PBGC deficit. Thus, using the more recent PBGC experience to predict the future will cause overstatement of future liabilities as well.

Another observation is that ERISA's funding rules are reducing the number of plans with unfunded liabilities and this is reducing the PBGC's risk exposure. Hence, using the past to project the future without recognizing the impact of ERISA funding rules will result in an overstatement of future liabilities. Finally the PBGC projection assumes that reforms in the program designed to reduce its risk exposure will not be enacted.

To our knowledge, the PBGC has not stated whether its deficit projection considered these factors. If it did not, the \$7.00 request is too much. If it did, then \$7.00 may still be too much because of the considerations discussed below.

Must premiums be increased now?

The PBGC has urged that the projected deficit be eliminated as quickly as possible, suggesting that 10 years or less is a suitable time span. They also urge a retroactive effective date—January 1, 1984.

We are opposed to making any increase retroactive. The PBGC has adequate assets on hand to cover its liabilities for several years. Making the premium increase retroactive will only serve to complicate the accounting, collection and processing of the premiums. Absent an overriding consideration we strongly urge a prospective effective date—January 1, 1985.

Several of our members believe it is unfair to have premium payers reduce the PBGC's deficit over a shorter period than ERISA obligates them to fund their own pension plans. They ask, "Why should we fund some other company's abandoned pension faster than we fund the pensions for our own employees?" Increasing the amortization period will also reduce the size of the premium increase, they add. We agree and suggest that a 16 year amortization period for reducing the deficit is a reasonable period.

Should premium increase be linked to reforms?

During the course of the Chamber's review of the single-employer program, we found serious shortcomings that need to be corrected if pension plan sponsors and participants are to be fairly treated. We found that the present provisions of the law:

(1) Are too severe for many sponsors of terminating plans because they require full payment of any deficiency for guaranteed benefits in a single sum on termination, although benefit payments generally will be spread over many years following termination;

(2) Are too lenient for certain sponsors of terminating plans because they limit the liability for healthy, continuing employers to less than the funding deficiency for the promised benefits, while passing the rest to the insurance system and its premium payers;

(3) Require the PBGC to take over the administration of all insufficiently funded plans at termination, even where the sponsors are willing and able to complete the funding and continue the administration of the terminated plan;

(4) Permit the vested benefits of insufficiently funded plans to be c. ' back to the level of guaranteed benefits, even where the sponsors are able to fund vested benefits fully; and,

(5) *Provide questionable guarantees* in which identical benefit guarantees are given to pension plans with sharply different eligibility, vesting, service, and benefit formulas.

Correction of these problems ought to be linked to any premium increase authorized by Congress.

What reforms are needed?

The Chamber and other employer organizations have stated that, in addition to a premium increase, Congress should revise the single employer program to prevent plan sponsors with low net worth from transferring significant unfunded liabilities to the PBGC, either directly via plan termination, or indirectly through spin-off of the poorly funded plan to a financially weak sponsor who subsequently terminates the plan and allows the predecessor to escape liability.

These reforms can be accomplished by restricting guarantee insurance to cases of extreme hardship (i.e. the situation where continuance of the plan threatens survival of the firm itself or where bankruptcy has been declared). In all other instances, the plan sponsor should be held accountable for all accrued benefits up to the date of the plan's termination.

To prevent the transfer of unfunded pension obligations through indirect means, such as divestitures or mergers, a new category of contingent transfer or liability should be established in which the sponsor of an unfunded plan would be contingently liable for up to five years for the unfunded liability of the plan at the time of sale or change in the plan sponsorship. To assure fair treatment and avoid harassment of many small plan transfers, (1) the contingent liability should be phased out over the five year period, and (2) small plan transfer (under \$500,000 in unfunded plan liability) should be exempted from the contingent liability.

All the above reforms should be effective as of the date of enactment and none should have retroactive application.

Does pending legislation adequately address these reform recommendations?

When introduced, H.R. 3930, pending in the House Education and Labor Committee, would link the premium increase to the reforms we have advocated, we find this legislation to be deficient in several respects:

(1) The premium increase and reform provisions are retroactive;

(2) Employer liability is expanded too much as a result of (a) a new definition of the control group from 80% to 50% ownership and (b) requiring employers to fund for ancillary benefits upon plan termination;

(3) Contingent and transfer liability rules are too complex and difficult to interpret;

(4) It is inappropriate to give unions veto power over proposed plan terminations.

We have been working with the labor committee and we have reason to believe the bill will be revised in response to these objections. We hope to be able to support revised legislation.

Chairman RANGEL. You mean at this time we can expect to hear from the chamber.

Mr. FRANKLIN. Yes, sir.

Chairman RANGEL. The National Association of Manufacturers, Mr. Boyd.

STATEMENT OF THOMAS B. BOYD, JR., VICE PRESIDENT, PENSION OPERATIONS, EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES, ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS, ACCOMPANIED BY SHARON CANNER, ASSOCIATE DIRECTOR OF EMPLOYEE BENEFITS, NAM

Mr. BOYD. Mr. Chairman and members of the subcommittee, I am Tom Boyd, vice president of Government Operations for Pensions of the Equitable Life Assurance Society of the United States,

which, alluding to Ms. Ferguson's remarks earlier, is clearly not a fly-by-night insurance company. We will be celebrating our 125th anniversary this Thursday.

I am appearing today in my capacity as a member of the National Association of Manufacturers, Employee Benefits Committee and its Pension Subcommittee. Accompanying me is Sharon Canner, Associate Director of Employee Benefits at the NAM.

The National Association of Manufacturers is a voluntary business association of over 13,500 corporations, large and small, located in every State. NAM member companies employ 85 percent of all workers in manufacturing, and produce over 80 percent of the Nation's manufactured goods.

At this time I would like to abridge my statement somewhat in the interest of time.

The NAM welcomes this opportunity to comment on the present Reagan administration request to increase the premium of the Pension Benefit Guaranty Corporation from \$2.60 to \$7 per year per participant. While we recognize the need for some premium increase, as have the other members at this table, we have endorsed a \$6 premium effective January 1, 1984. We believe that any premium increase should not be considered in isolation.

Title IV of the Employee Retirement Income Security Act of 1974 created the PBGC to act as an insurer of private sector pension plans which terminate without sufficient assets to pay benefits to plan participants. The cost of administering and financing the single employer termination insurance program is borne by plan sponsors who are assessed an annual fee called a premium.

The current premium structure is based upon a flat rate which charges plan sponsors relative to the number of participants in the pension plan. However, in the 10 years since enactment of ERISA, the termination insurance system for single employer plans has proven to be in need of readjustment.

There is pending in the House of Representatives a title IV reform measure, H.R. 3930, which, while imperfect at this time, deserves full consideration by the subcommittee and the Congress. H.R. 3930 includes a premium increase to \$6 for the PBGC and a number of important reforms to shore up the title IV single employer insurance program. Whether the final premium is \$6 or \$7, the reforms recommended in H.R. 3930 should be included with any legislative effort to increase the premium.

Why does the title IV program need amendment and what reforms are needed? In brief, the title IV pension insurance program has been found by the premium paying sponsor community to be a flawed vehicle. Many of the problems of the current federally sponsored pension insurance system may be traced directly to the rigidity of the current plan termination event.

On the one hand, plan sponsors, subject to contractual limitations, should be permitted to terminate a plan to meet the requirements of a changing business environment. On the other hand, plan termination as currently structured may actually encourage some employers to shift their obligation to pay benefits to the PBGC and to the detriment of premium payers, participants and the insurance system.

In essence, the current 30 percent of net worth test permits some plan sponsors with a low net worth and a significantly underfunded pension plan to transfer liabilities onto the PBGC and therefore to pass pension costs along to the premium paying community. This transfer of liabilities may also occur as a result of a sale or spin-off of a plan sponsor from a financially healthy parent or control group to a weaker entity. Current law is essentially powerless to contain or control these transfers and since no showing of hardship is necessary to terminate a pension plan and receive full PBGC coverage, the PBGC must in most cases accept the termination.

The NAM therefore supports title IV reform based upon the following policy objective:

One, financing of current funding deficiencies and future obligations in the pension insurance system through a reasonable premium increase;

Two, adding safeguards to the current pension insurance system to prevent plan sponsors with low net worth from transferring significant unfunded liabilities to the PBGC directly through termination or indirectly through spinoffs or transfer of poorly funded plans;

Three, encouraging plan sponsors through a rational termination mechanism to fund and deliver full vested benefits;

Four, permitting under circumstances of demonstrable hardship relief for plan sponsors from the obligation to fund these full benefits; and

Five, basing the PBGC premium structure for single employee plan sponsors upon the risk that a pension plan has of terminating in an underfunded position and transferring that underfunded liability to the PBGC.

In conclusion, the NAM will support no premium increase unless it is included with a title IV reform bill which emphasizes private sector solutions; provides certainty for plan sponsors seeking relief through the title IV insurance system; adds new safeguards to prevent spinoff terminations; and retains the contractual and statutory rights in existing law for plan sponsors, participants and their duly elected representatives.

In addition, we encourage a study to be made to determine the measurement of a risk-related premium.

In summary, the NAM encourages the Congress to move swiftly to enact the much-needed reforms of the title IV single employer termination insurance program.

[The prepared statement follows:]

STATEMENT OF THOMAS BOYD, JR., VICE PRESIDENT, PENSION OPERATIONS, THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES, ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. Chairman and members of the Subcommittee, I am Tom Boyd, Vice President of Government Operations for Pensions of the Equitable Life Assurance Society of the United States. I am appearing today in my capacity as a member of the National Association of Manufacturers' Employee Benefits Committee and its Pension Subcommittee. Accompanying me today is Sharon Canner, Associate Director of Employee Benefits at the NAM.

The National Association of Manufacturers is a voluntary business association of over 13,500 corporations, large and small, located in every state. Members range in size from the very large to over 9,000 smaller manufacturing firms, each with an

employee base of less than 500. NAM member companies employ 85 percent of all workers in manufacturing and produce over 80 percent of the nation's manufactured goods. NAM is affiliated with an additional 158,000 business through its Associations Council and the National Industrial Council.

The NAM welcomes this opportunity to comment on the present Reagan Administration request to increase the premium of the Pension Benefit Guaranty Corporation (PBGC) from \$2.60 to \$7.00 per year per participant. While we recognize the need for some premium increase at this time, we believe that the premium request should not be considered in isolation.

Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) created the PBGC to act as an insurer of private sector pension plans which terminate without sufficient assets to pay benefits to plan participants. The cost of administering and financing the single employer termination insurance program is borne by plan sponsors who are assessing an annual fee called a premium. The current premium structure is based upon a flat rate which charges plan sponsors relative to the number of participants in the pension plan. However, in the ten years since enactment of ERISA, the termination insurance system for single employer plans has proven to be in need of readjustment.

There is pending in the House of Representatives, a Title IV Reform measure (H.R. 3930) which, while imperfect at this time, deserves full consideration by this subcommittee and the Congress. H.R. 3930 includes a premium increase to \$6.00 for the PBGC and a number of important reforms to shore up the Title IV Single Employer Insurance program. Whether the final premium is \$6.00 or \$7.00, the reforms recommended in H.R. 3930 should be included with any legislative effort to increase the PBGC premium.

Why does the Title IV program need amendment and what reforms are needed? In brief, the Title IV Pension Insurance program has been found by the premium paying plan sponsor community to be a flawed vehicle. Many of the problems of the current federally-sponsored pension insurance system may be traced directly to the rigidity of the current plan termination event. On the one hand, plan sponsors, subject to contractual limitations, should be permitted to terminate a plan to meet the requirements of a changing business environment. On the other hand, plan termination as currently structured may actually encourage some employers to shift their obligation to pay benefits to the PBGC to the detriment of premium payers, participants and the insurance system.

In essence, the 30 percent of net worth test permits some plan sponsors with a low net worth and a significantly underfunded pension plan to transfer liabilities onto the PBGC and therefore to pass pension costs along to the premium paying community. This transfer of liabilities may also occur as a result of a sale or spin-off of a plan sponsor from a financially healthy parent or control group to a weaker entity. Current law is essentially powerless to contain or control these transfers and since no showing of hardship is necessary to terminate a pension plan and receive full PBGC coverage, the PBGC must in most cases accept the termination. The NAM therefore supports the Title IV reform based upon the following objectives.

1. Financing of current funding deficiencies and future obligations in the pension insurance system through a reasonable premium increase;

2. Adding safeguards to the current pension insurance system to prevent plan sponsors with low net worth from transferring significant unfunded liabilities to the PBGC directly through termination or indirectly through spin-offs and transfer of poorly-funded pension plans;

3. Encouraging plan sponsors through a rational termination mechanism to fund and deliver full vested benefits;

4. Permitting under circumstances of demonstrable hardship, relief for plan sponsors from the obligation to fund these benefits, and;

5. Basing the PBGC premium structure for single employee plan sponsors upon the risk that a pension plan has of terminating in an underfunded position and transferring that underfunded liability to the PBGC for payment.

In conclusion, the NAM will support no premium increase unless it is included with a Title IV reform bill which:

1. Emphasizes private sector solutions for all plans not in distress, which in H.R. 3930, is called a "Standard termination event";

2. Provides certainty for plan sponsors seeking relief through the Title IV insurance system only in cases of demonstrable hardship;

3. Adds new safeguards to the Title IV program without unduly burdening normal business transactions; and

4. Retains contractual and statutory rights in existing law for plan sponsors, participants and their duly elected representatives; and

5. Provides for a study to be made to determine the measurement of a risk related premium.

In summary, the NAM encourages the Congress to move swiftly to enact the much needed reforms of the Title IV single employer termination insurance program.

Thank you, Mr. Chairman and members of the Subcommittee.

Chairman RANGEL. Determination of what?

Mr. BOYD. I might add this is in the current proposal of H.R. 3930. The NAM, as well as other business entities, have encouraged the study of the premium structure as currently constituted with an idea of whether or not there should be a risk-related premium, and also so that hopefully the next time that we come before the Congress to discuss a premium increase, the level of information in the public environment will be higher than it is now.

In every premium increase the same criticisms have come forward, and it is our feeling that if we study the premium structure, the assumptions upon which it is based, that the next time around we will have sufficient information to agree or disagree up front.

Chairman RANGEL. Let me tell you where I have a problem, Mr. Boyd.

First of all, I hope you were here when I asked the same thing of the Corporation. They told me that they had concluded the report that you and I are seeking and that they assured the subcommittee that they will be able to submit that. Now, I gather that, when you ask for a study, in and of itself, you are going to strike that out now because you are going to have that. But, you mentioned something else about needing a study so that you'll have more information when further requests for a premium increase would be before the Congress.

Now, you are going to have that information. And so when you say study, you do not mean to infer that you do not believe that a crisis exists, and that we should vote merely for a study now and deal with the premium request at some other time, do you?

Mr. BOYD. Absolutely not. In fact, the two requests are quite separate. The request that I have asked for in my testimony for a study is for the long-range implications of determining the premium rate for the PBGC.

Chairman RANGEL. Well, if I might restate your testimony here, your point is that the request the Chair just made to the Corporation is not a sufficient study in and of itself.

Mr. BOYD. It depends on what question you are asking. If the question you are asking is will it be sufficient for us to make up our mind on the \$7 premium, I would suggest that it probably will, that in fact we have already endorsed as of last year the \$6 premium effective January 1, 1984, and we are only a buck apart.

Chairman RANGEL. So to be more positive, instead of testifying as to what you would not support, all of you would support a premium increase as long as it is coupled with substantial reform, and if you have sufficient information before you to determine whether that figure now should be \$7.

Mr. BOYD. I think that is fair to say, yes, sir.

Chairman RANGEL. Well, then, one of the problems that the chamber said that you had is that there is no formal way for you to

reflect these concerns except when legislation is before the Congress.

Well, if this legislation is as important as most people believe it is—unions, employees, manufacturers, employers and the administration—then it would seem to me that we should be able to establish some mechanism. It just seems that we all can't walk away from the problem simply saying that there is a problem there and the Congress should do something about it.

Now just for your consideration, I am suggesting you could go to the drawing board and raise all of the questions that you've referred to at this hearing. You could request the information or at least the basis for PBGC's projections that have been made or what you think you need to make an intelligent decision.

As soon as we get that, we will take your requests as though they are the subcommittee's requests and present them to the Corporation for answers. We'll see that you receive them. And, I hope that all of you are saying that then you will be able to, in a more definitive way, state whether you can or cannot support the legislation dealing with the premium and reforms. I hope you can say with certainty these are the reforms we need and are locked in to support. You might even say these are the things that we hope you would include.

Mr. BOYD. We would be happy to do that.

Chairman RANGEL. Do you think that might help in terms of establishing a meeting of minds on how swiftly the Congress should act? Because unless we have some of you in front of us, we are not prepared to go home and say that there should be an increase in the premium and hope that the voters understand we're trying to protect employees.

So let's try and see how that works, and we will pause for Mr. Pickle to see. They have agreed in general that we will take their request for additional information and submit it to the Corporation.

Mr. PICKLE. That may be a good approach, Mr. Chairman.

Mr. Franklin, on page 7 of your testimony you list four categories in which you indicate that legislation as introduced would be deficient and we ought to have corrections in those four categories. You said you have been working with the Labor Committee, and we have reason to believe that the bill be revised in response.

Have you received some positive indication from them that they would take corrections along the lines you have listed?

Mr. FRANKLIN. Yes, sir. We have talked to the Senate, and the Senate has indicated a willingness to make some changes. There was a bill made available last Thursday, and we were told it has changed again on Monday. These targets have moved around on us a lot, and it has been difficult for us to know what committees are settling on things in mark-up sessions.

Mr. PICKLE. But in general, if these provisions were met or could be accommodated, then you could support the legislation?

Mr. FRANKLIN. Yes, sir.

Mr. PICKLE. Then the only question would be the amount of the increase.

Mr. FRANKLIN. Yes, sir.

Mr. PICKLE. All right, thank you, Mr. Chairman.

Chairman RANGEL. Let me thank you for what I think was cooperation in this matter, and we hope that you do not wait for another hearing. We hope that you would feel free to be working with our staffs in a very informal way.

Are there any other questions?

[No response.]

Chairman RANGEL. OK. Thank you very much.

The last panel is Mr. Elmer Chatak, secretary-treasurer of the Industrial Union Department of the AFL-CIO, and he will bring with him Mr. Richard Prosten, the research director, and Alan Reuther, the assistant general counsel to the United Automobile Workers.

Also testifying will be Richard Raskin, chairman of the Committee on Title IV of ERISA for the Association of Private Pension and Welfare Plans; and from the American Association of Retired Persons, James M. Hacking, assistant legislative counsel.

We thank you for your patience with the subcommittee. All of you know that your entire statements, by unanimous consent, will be entered into the record. Those of you that had the benefit of listening to prior testimony could feel free to comment on it, and you are invited to summarize your statement

Mr. Chatak? Am I pronouncing that correctly?

STATEMENT OF ELMER CHATAK, SECRETARY-TREASURER, INDUSTRIAL UNION DEPARTMENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, ACCOMPANIED BY RICHARD PROSTEN, RESEARCH DIRECTOR; AND ALAN REUTHER, ASSISTANT GENERAL COUNSEL, UAW

Mr. CHATAK. You are close.

There are not too many unless you happen to be from the western part of Pennsylvania. Western Pennsylvanians say it is a good honky name.

Based on some of the questions you have asked, Mr. Chairman, I could make my statement in a few words. We support the \$7 premium. You have been fishing around here—I am saying that half in jest, but I noticed with the other witnesses you were trying to draw them out on some specific figures.

I am going to summarize. You have our statement. Initially I would like to submit for the record a letter from the AFL-CIO Legislative Director Ray Dennison—they were unable to appear today—and at your pleasure, they would like to submit this letter for the record on the issue before you.

[The letter follows:]

AMERICAN FEDERATION OF LABOR AND
CONGRESS OF INDUSTRIAL ORGANIZATIONS,
Washington, D.C., March 20, 1984.

HON. CHARLES RANGEL,
Chairman, Oversight Subcommittee, Ways and Means Committee, U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: The AFL-CIO is concerned with the problems which have developed under the single employer pension plan termination insurance program and appreciates the opportunity to present our views on how to deal with some of these problems.

The AFL-CIO has a strong and long standing commitment to protect pensions earned by American workers. We supported the passage of the Employee Retire-

ment Income Security Act (ERISA) including the termination insurance provisions of that legislation. We still support the concept of termination insurance but are concerned about the financial condition of the Pension Benefit Guaranty Corporation (PBGC) and the need to improve the program so as to increase the likelihood that workers will receive promised benefits.

We believe that legislation similar to H.R. 3930, the Single Employer Pension Plan Amendments Act of 1983, would address our concerns and deal effectively with the program's problems. The Labor-Management Relations Subcommittee of the House Education and Labor Committee has reported this bill. This legislation addresses the problem in a way that is fair to plan participants and is generally acceptable to the Pension Benefit Guaranty Corporation and to the private pension community.

In any event, the very least that should be done is to increase the premium paid by employers to the PBGC, for the single employer termination insurance program, the annual premium is currently \$2.60 per participant. The long term liabilities of the PBGC, mostly pension benefits due workers in the future, currently exceed its assets by substantial amounts. In order to eliminate this deficit it is essential to increase the annual premium to \$7.00 per participant. We believe that prompt action to deal with PBGC's deficit by raising the premium is imperative.

Though the AFL-CIO supports reforming the single employer termination insurance program, we are concerned about ill-advised attempts to attach extraneous amendments to this legislation as it goes through Congress. We are particularly concerned about amendments to the multiemployer termination insurance program. Hasty action on amendments changing such a complex law will only endanger the progress and stability that has been achieved and hamper further progress. For these reasons, the AFL-CIO will oppose the passage of pension legislation if it includes amendments to the multiemployer termination insurance program.

Sincerely,

RAY DENISON,
Director, Department of Legislation.

Chairman RANGEL. You may want to address, if you are prepared to do so today, some of the concerns that were raised by a previous witness as to what protection this legislation would give to nonunion workers. It has been my experience that unions are concerned about the work force as opposed to just their own members. It is not necessary that you address yourself to that today; but it is a legitimate question, and I hope your research staff might take a look at it for the subcommittee.

Mr. CHATAK. We may be able to deal with that today.

I have with me two experts. Coincidentally, I guess it is an indication of your age. I had the pleasure of working with Walter Reuther a little over 20 years ago, and now I find his nephew here at my right side. It is a sign of the times that you are getting a little older.

Chairman RANGEL. Well, I noticed the similarity of the names myself and took a quick look.

Mr. CHATAK. We wish to thank you for the opportunity to present our views on the financial status of the PBGC and modifications which are being considered in the single employer pension plan termination insurance program. We commend you, Mr. Chairman, and you have cited the urgency.

We strongly support the enactment of comprehensive legislation to reform and strengthen the termination insurance program for single employer pension plans. We believe that legislation similar to the bill which has been reported by the Labor-Management Relations Subcommittee of the House Education and Labor Committee, H.R. 3930, would deal effectively with the problems which have arisen under title IV in a manner that is acceptable to PBGC and the various interested parties in the private pension community.

At a minimum, the IUD believes action is needed to increase the premiums paid by plan sponsors to the PBGC under the single employer termination insurance plan.

At the outset, I would like to stress our conviction that, taken as a whole, the single employer termination insurance program established under title IV of ERISA has been quite successful in achieving the objectives which it was intended to accomplish when Congress enacted ERISA in 1974 and determined that workers should be insured against the loss of anticipated pension benefits due to business failures and other events which prevent an employer from continuing a pension plan.

Since that time the economy has experienced two severe recessions which resulted in thousands of plant closings and pension plan terminations. In many of those situations, the PBGC played a crucial role in assuring that participants received at least some pension benefits.

We strongly support PBGC's request for a premium increase. In the past we supported the \$6 increase, but due to the passage of time, their current request for a \$7 increase certainly is reasonable.

We note that this request was contained in budget proposals presented by the administration, and proposals for a substantial premium increase are also contained in legislation which has already been reported by the House and the Senate Labor Committee, H.R. 3930 and the substitute S. 1227.

There is widespread agreement in our view, therefore, that a premium increase is necessary to properly finance the current funding deficiencies and future obligations of PBGC. The financial pressures currently facing the termination insurance program have been caused largely by two severe economic recessions which have led to an increased number of plan terminations.

The financial pressures on the PBGC have also been aggravated by certain loopholes in title IV which were addressed earlier. These loopholes permit solvent employers to avoid payment of their obligations to participants and to shift unfunded pension liabilities onto the termination insurance program and indirectly onto the other premium payers.

We believe the loopholes can be adequately closed with the type of comprehensive legislation which has been reported by the House Labor-Management Committee, H.R. 3930. It is important to recognize that the bills which are pending in Congress to reform and strengthen the single employer termination insurance plan constitute very modest and narrowly drawn pieces of legislation.

The bills deal only with the single employer termination insurance program. They do not affect the multiemployer program in any way. They simply preserve the existing level of benefits guaranteed by PBGC. They do not expand either the amount of benefits which are guaranteed by or the liabilities of PBGC. They avoid any reductions in the protections currently provided by the PBGC without aggravating the difficult budgetary problems currently facing Congress.

The IUD and its affiliates have consistently taken the position that any legislation which seeks to address the problems in the

single employer termination insurance program should embody the following policy objectives.

First and foremost, we believe any legislation should reaffirm and strengthen the national policy favoring the maintenance and growth of defined benefit pension plans. Accordingly, the primary objective of any legislation should be to provide strong disincentives for plan terminations.

Second, any legislation should close the loopholes which have developed under title IV and remove the opportunity for solvent, ongoing employers to "dump" their unfunded pension liabilities onto PBGC. The IUD also strongly believes that the problem of solvent ongoing employers evading responsibility for plan benefits which are not guaranteed by the PBGC must be resolved in any comprehensive legislation.

I have a horror story here but I am going to pass on it. I would urge that the committee take a look at it. It is a very serious situation where an employer opted to cancel a plan and save quite a few dollars. It is in the record. I am sure there are many others that could be provided if the committee so chose. This was in light of profits, after-tax profits of \$123 million in 1980, \$149 million in 1981, \$129 million in 1982. There was no problem of inability here, but it was just taking advantage of loopholes.

Chairman RANGEL. The Chair will pull that out and take a look at it.

Mr. CHATAK. H.R. 3930 contains mechanisms for preventing this kind of abuse. Accordingly, we support this bill.

[The prepared statement follows:]

STATEMENT OF ELMER CHATAK, SECRETARY-TREASURER, INDUSTRIAL UNION
DEPARTMENT, AFL-CIO

Mr. Chairman, my name is Elmer Chatak. I am Secretary-Treasurer of the Industrial Union Department of the AFL-CIO. The Industrial Union Department has 54 affiliated unions representing approximately 5 million workers, most of whom are covered by negotiated single-employer plans.

We wish to thank you for the opportunity to present our views on the financial status of the PBGC, and modifications which are being considered in the single-employer pension plan termination insurance program. We commend you, Mr. Chairman, and the Members of this Subcommittee for holding hearings on this subject, which is so important to our affiliates, their members and families.

The IUD strongly supports the enactment of comprehensive legislation to reform and strengthen the termination insurance program for single-employer pension plans. We believe that legislation similar to the bill which has been reported by the Labor-Management Relations Subcommittee of the House Education and Labor Committee (H.R. 3930) would deal effectively with the problems which have arisen under Title IV, in a manner that is acceptable to the PBGC and the various interested parties in the private pension community.

At a minimum, the IUD believes action is needed to increase the premiums paid by plan sponsors to the PBGC under the single-employer termination insurance program. Unless Congress acts promptly to increase the premiums, the financial pressures on the PBGC will continue to grow, which will in turn generate demands to cut back on the protections afforded participants under the program. The IUD therefore strongly supports the PBGC's request for a premium increase, and urges this Subcommittee to act promptly on this proposal.

OPERATION OF THE TERMINATION INSURANCE PROGRAM

At the outset, the IUD would like to stress its conviction that, taken as a whole, the single-employer termination insurance program established under Title IV of ERISA has been quite successful in achieving the objectives which it was intended to accomplish. When Congress enacted ERISA in 1974, it determined that workers

should be insured against the loss of anticipated pension benefits due to business failures and other events which prevent an employer from continuing a pension plan. Since that time, the economy has experienced two severe recessions, which resulted in thousands of plant closings and pension plan terminations. In many of those situations, the PBGC played a crucial role in insuring that participants received a least some pension benefits. The members of the IUD's affiliates, who have been hit particularly hard by the trauma of plant closings and plan terminations during these difficult economic times, have found the termination insurance program to be of invaluable assistance in assuring their retirement income security.

The IUD and its affiliates strongly advocated plan termination insurance when ERISA was first being considered by Congress. In light of the experience of our affiliates and their members during the 10 years since ERISA was enacted, the IUD remains strongly committed to the termination insurance program and the goals embodied in Title IV. That is why we have worked with Members of the House and Senate and other interested parties to develop legislation to improve and strengthen the program. We believe that the level of insurance protection afforded participants under Title IV ought to be improved. However, given the financial difficulties currently facing the PBGC, we are willing to accept the preservation of existing benefit guarantees at the present time. We would vehemently oppose any attempt to cut back or weaken the protections afforded to participants under the program.

PREMIUM INCREASE

The IUD strongly supports the PBGC's request for a premium increase. In the past we have supported their request to increase the premium for single-employer plans to \$6.00. Due to the passage of time, their current request for an increase to \$7.00 certainly is reasonable. We note that this request was contained in budget proposals presented by the Administration. And proposals for a substantial premium increase are also contained in legislation which has already been reported by the House and Senate Labor Subcommittees (H.R. 3930 and the substitute for S. 1227). There is widespread agreement, therefore, that a premium increase is necessary to properly finance the current funding deficiency and future obligations of the PBGC.

Although the PBGC's request to increase the single-employer annual premium from \$2.60 to \$7 seems large, it is important to note that this increase is not terribly large in absolute terms. The proposed increase would only amount to about one third of a cent per hour in labor costs, which is hardly a large price to pay for such valuable protection for the retirement income security of participants. If anything, we believe that the PBGC's request for a premium increase may be overly conservative. Given the general increase in the value of pension benefits, the long term obligations of the PBGC may actually turn out to be higher than has been estimated. Accordingly, the PBGC's request for a premium increase should be viewed as a moderate proposal.

The financial pressures currently facing the termination insurance program have been caused largely by two severe economic recessions, which have led to an increased number of plan terminations that have involved the PBGC. In the long run, these problems can only be solved by government policies which promote a return to a full employment economy. Immediate action is necessary, however, to address the financing problems facing the PBGC, in order to assure the financial solvency of the program and to avoid pressure to reduce the protections afforded to participants' pension benefits under the program.

The financial pressures on the PBGC have also been aggravated by certain loopholes in Title IV, which permit solvent employers to avoid payment of their obligations to participants, and to shift unfunded pension liabilities onto the termination insurance program (and indirectly onto the other premium payors). We believe these problems are likely to get worse, and hence the financial pressures on the PBGC and other premiums payors will continue to grow, unless prompt action is also taken to amend Title IV to close the current loopholes. We would like to emphasize, however, that there is no need for any fundamental restructuring of the termination insurance program, and certainly no reason to cut back or abandon the protections it provides to participants. We believe the loopholes can be adequately closed through the type of comprehensive legislation which has been reported by the House Labor-Management Relations Subcommittee (H.R. 3930). In the event prompt action on such legislation is not possible, one alternative the Subcommittee may wish to consider is enacting a premium increase in excess of that requested by the PBGC (perhaps \$8 or \$9), but with the proviso that the premium would be automatically reduced to \$6 or \$7 upon the passage of more comprehensive reforms in the Title IV program.

COMPREHENSIVE REFORMS

It is important to recognize that the bills which are pending in Congress to reform and strengthen the single-employer termination insurance program constitute very modest and narrowly drawn pieces of legislation. The bills: Deal only with the single-employer termination insurance program; they do not affect the multi-employer program in any way; simply preserve the existing level of benefits guaranteed by the PBGC; they do not expand either the amount of benefits which are guaranteed by or the liabilities of the PBGC; avoid any reductions in the protections currently provided by the PBGC, without aggravating the difficult budgetary problems currently facing Congress.

The IUD and its affiliates have consistently taken the position that any legislation which seeks to address the problems in the single-employer termination insurance program should embody the following policy objectives.

First and foremost, we believe any legislation should reaffirm and strengthen the national policy favoring the maintenance and growth of defined benefit pension plans. Accordingly, the primary objective of any legislation should be to provide strong disincentives for plan terminations by requiring solvent, ongoing employers to fund and deliver the full amount of accrued benefits to all plan participants. In particular, employers should continue to be obligated for any benefits which are not guaranteed by the PBGC after a plan is terminated, so long as they continue in business and are solvent.

Second, any legislation should close the loopholes which have developed under Title IV, and remove the opportunity for solvent, ongoing employers to "dump" their unfunded pension liabilities onto the PBGC. In the event a plan is terminated, the PBGC should have an expanded right to recover the shortfall between plan assets and the cost of guaranteed benefits.

The IUD believes that the bipartisan legislation which has been reported by the House Labor-Management Relations Subcommittee, H.R. 3930, represents a constructive and balanced proposal that satisfies these central objectives. We are disappointed that this bill does not go further towards resolving certain problems, and in particular, towards assuring that plan participants continue to receive their full benefits, including any benefits not guaranteed by the PBGC, so long as their employer continues in business after a plan termination. Nevertheless, we recognize that all interested parties will have to accept some compromises if there is to be any hope of enacting effective and acceptable legislation in the current Congress. With this in mind, the IUD and its affiliates have supported H.R. 3930. We strongly urge the Members of this Subcommittee to join in cosponsoring and supporting this bipartisan measure.

A. Transfer of unfunded liabilities to the PBGC

The IUD believes that the loopholes in Title IV which permit solvent, ongoing employers to "dump" their unfunded pension liabilities onto the PBGC should be closed by making four changes in Title IV:

(1) in situations where the shortfall between plan assets and the cost of guaranteed benefits exceeds 30 percent of the employer's net worth, the PBGC should be given an additional claim for 10 percent of the employer's pre-tax profits for a period of ten years, or until the shortfall is made up, if sooner;

(2) in situations where an employer would otherwise be relieved of its obligations under a plan because of a sale, spinoff, division or other business transaction, new contingent liability rules should continue to impose secondary liability on the employer for a reasonable period of time;

(3) the definition of "control group" should be expanded to incorporate a 50 percent rather than an 80 percent ownership test; and

(4) employers should only be permitted to transfer their unfunded pension liabilities to the PBGC in situations where they can qualify for a "distress termination", by satisfying certain objective criteria which indicate that they are experiencing severe hardship.

Taken together, these four changes should effectively close the loopholes in Title IV. Granting PBGC an additional claim on the employer's pre-tax profits should prevent the "dumping" problem in situations where the employer has a low or negative net worth, but nevertheless remains in business and continues to earn a profit. The contingent liability rules and expansion of the control group test keep employers from being able to dump their unfunded pension liabilities in cases where there is a sale, spinoff, division or other manipulation of ownership. And most importantly, the provisions limiting access to the termination insurance system to those cases where an employer can satisfy objective criteria of severe hardship should prevent

plan sponsors from searching for new ways to "game" the system, while still affording relief to employers in cases of genuine distress.

Although these four proposals would effectively close the loopholes in the termination insurance program, they would not place undue burdens on plan sponsors. For example, the PBGC's claim for 10 percent of the employer's pre-tax profits is not an excessive portion, and does not impose any fixed obligation on unprofitable businesses. Furthermore, there is no additional obligation where the shortfall between plan assets and the cost of guaranteed benefits does not exceed 30% of the employer's net worth.

In addition, the establishment of contingent liability in situations where there is a sale, spinoff, division or other manipulation of ownership can be tempered by appropriate exemptions for small business and other safe harbors. And the expansion of the control group test can also be moderated by provisions limiting the liability of subsidiaries for the pension obligations of their parent corporations in cases where the subsidiary is less than 80% owned by the parent corporation.

Establishing a distinction between "standard terminations"—essentially equivalent to the "freezing" of benefit accruals that is currently permitted under IRS rules—and "distress terminations"—cases where the benefit guarantee provisions of the Title IV would take effect if plan assets are insufficient—would also be a major procedural improvement. The PBGC's workload and administrative expenses should be significantly less since it will have minimal involvement with standard terminations and can focus on the relatively small number of distress terminations.

Most importantly, employers would continue to have alternatives to make reductions in their pension costs, including requesting funding waivers from the IRS, as well as "freezing" benefit accruals under a "standard termination". At the same time, plan participants would not suffer benefit reductions unless the employer is experiencing severe economic hardship which justifies a "distress termination".

The IUD notes that H.R. 3930 embodies all four of the elements described above. We believe that this bill would effectively close the loopholes which currently permit solvent, ongoing employers to dump their unfunded pension liabilities onto the PBGC. We therefore fully support these portions of H.R. 3930.

B. Obligation of ongoing employers for nonguaranteed benefits

The IUD also strongly believes that the problem of solvent, ongoing employers evading responsibility for plan benefits which are not guaranteed by the PBGC must be resolved in any comprehensive legislation through two mechanisms:

(1) in situations where a plan enters a "standard termination", the employer should be required to continue to fund and deliver full plan benefits, including benefits not guaranteed by the PBGC; this is true even where the plan is otherwise "sufficient" for PBGC purposes;

(2) in situations where a plan enters a "distress termination", the employer should be required to pay 5 percent of its pre-tax profits for a period of ten years (or until all nonguaranteed benefits are funded, if sooner) into a special termination trust; the monies in the trust would be used to make up the difference between the level of benefits guaranteed by the PBGC and the full level benefits promised under the plan.

Enactment of these proposals would represent an improvement over existing law, under which an employer can simply walk away from responsibilities for nonguaranteed benefits, even in cases where it continues and is highly profitable. These proposals would increase the likelihood that at least part of the nonguaranteed benefits would continue to be paid.

We note that the approach embodied in the second part of these proposals relating to termination trusts still would not provide complete assurance that participants will continue to receive all benefits promised under a plan. Under this approach, the payments of any nonguaranteed benefits still could be delayed until after the end of an employer's fiscal year, rather than being paid on a timely basis. More importantly, because the payment of these benefits would be made contingent on the existence and extent of an employer's profits in any particular year, the amount of the payments could fluctuate from year to year. And, of course, if the 5 percent—which is a small share of profits—were not sufficient to cover all nonguaranteed benefits, those benefits would be lost, even though the employer might continue in business and eventually return to profitability. Because of these potential problems, the IUD believes it would be better to simply require employers to pay any nonguaranteed benefits on a pay as you go basis, in situations where they continue in business after a distress termination. However, limiting their obligation to 5 percent of profits represents a reasonable compromise, which should be effective in preventing the types of abuses which have occurred.

The problem of solvent, ongoing employers evading responsibility for nonguaranteed benefits is not an abstract question or an isolated phenomenon. The IUD and its affiliates have encountered this abuse in numerous situations. To illustrate the gravity of the problem, and the impact it can have on participants, let us recite one case.

A multi-national corporation with 46 divisions and subsidiaries and net sales of almost \$1.5 billion, used to operate an automotive division in Detroit, which produced parts for the automobile companies. The workers at this plant were represented by the UAW, and were covered under a negotiated pension plan that provided various benefits. In the later part of 1979 and early 1980, the corporation began to consider the possibility that the automotive division plant would have to be closed. In the course of its deliberations, it examined whether to "freeze" or terminate the pension plan. The corporation's pension experts advised that if the plan were "frozen", the firm would still be responsible for funding and delivering full plan benefits to participants. However, if the corporation terminated the plan, it could evade responsibility for plan benefits which were not guaranteed by the PBGC. The pension experts calculated that the present value of these nonguaranteed benefits was approximately \$2.4 million. Acting on the recommendation of these pension experts, the corporation not surprisingly decided to follow the second alternative, and to "save" \$2.4 million by terminating the plan when it closed the factory, thereby avoiding any obligations for the nonguaranteed benefits. As a result of the plan termination, benefits were reduced from the full level promised under the terms of the plan to the levels guaranteed by the PBGC. Early retirement supplements were lost, along with a portion of the basic benefits. Through subsequent litigation the UAW was able to force the corporation to restore some of the lost benefits. Nevertheless, the practical impact of the plan termination on some participants was quite dramatic. Participants who had worked for over thirty years and recently retired had their immediate monthly benefits cut from \$650 to approximately \$320. In all, 667 out of 839 retirees had their benefits reduced. At the same time that the corporation was terminating the plan and slashing the benefits of retirees, it reported pre-tax profits of over \$123, \$149 and \$129 million in fiscal years 1980, 1981 and 1982.

The IUD submits that Congress should not permit that type of abuse to continue. It is one thing for plan benefits to be cut back to PBGC guarantee levels where the employer goes out of business. But it is an entirely different matter to allow this to happen where the employer not only continues in business, but is earning profits. There is a general consensus that Title IV must be amended to prevent solvent employers from dumping their unfunded pension liabilities onto the PBGC. We submit that it is equally appropriate to amend Title IV so that ongoing employers cannot "dump" or evade their responsibilities to participants for nonguaranteed benefits promised under the plan.

H.R. 3930 embodies both of the mechanisms discussed above for preventing this type of abuse. Accordingly, the IUD supports these provisions of the bill.

C. Other matters

The IUD also believes that any comprehensive reform legislation should contain a number of other provisions to improve the termination insurance program. These include: Creating a lien in favor of a plan for 100% of the amount of any funding waiver; requiring plan sponsors to notify all interested parties (including labor unions representing participants) when they apply for a funding waiver; creating a mechanism to prevent pension plan terminations from being implemented where this would violate any statutory or contractual provision.

The IUD notes that H.R. 3930 incorporates provisions dealing with all three of these matters.

The IUD recognizes that there are a number of details in H.R. 3930 which may require further refinement. Some examples are the establishment of mechanisms for avoiding unnecessary and costly litigation over the net worth of employers, and the procedures for establishing termination trusts to assure payment of nonguaranteed benefits. We are prepared to work with the members of this Subcommittee, their staff and other interested parties to try to resolve these and other technical matters.

In conclusion, the IUD remains committed to the growth and development of defined benefit pension plans, and to strengthening and improving the termination insurance program. We would again like to thank the Chairman and members of this Subcommittee for holding hearings and giving us an opportunity to present our views on this important subject.

Chairman RANGEL. I imagine you would want to qualify that support, Mr. Chatak, because from what I understand, it has gone through many changes. In fact, we do not know what its final form is, and it has not been reported to the full committee.

I understand your statement to be that you certainly support it in concept. I would hope that this panel would feel free, the same way I asked a previous panel, to take a hard look at what is finally drafted by the Education and Labor Committee, and to feel free to share your views with our committee, as you know you feel free to share with Education and Labor. We'll want to know whether or not your support is still as firm as it was in the original bill when we finally come out with a bill.

Mr. CHATAK. We most certainly will.

Chairman RANGEL. So, you should feel free to have access to our staff, as I know you feel free with the other committee.

Mr. CHATAK. I have concluded my statement. If you would now wish us to address the issue of the unorganized, unrepresented workers, we will. Mr. Reuther will comment on that.

Mr. REUTHER. Mr. Chairman, the answer is that as far as the new protections that will be provided by the legislation, they will apply the same to the nonunion as well as union workers.

Right now the problem we have is that employers are able to terminate a plan and get out from under their responsibility for benefits which are not guaranteed by the PBGC. The proposed legislation would say that as long as the employer is solvent and ongoing, it would still have a responsibility for paying those benefits. That would apply to nonunion as well as union employees. So there is no difference in that regard.

Chairman RANGEL. Well, I suspect that no one would have a problem with that once we recognize that the employer has decided to establish a plan. We probably do not have any problem relating this to those plans that are established. But, we are going to have to lock into all of these single employer defined benefit plans a premium increase and a mechanism to avoid abuse.

What I do not really know, and maybe other members of the committee would, is whether this law would discourage employers who have no plans from establishing one. I do not know.

So I am suggesting that while there may not be a clear answer, it would be helpful if you could give it some thought.

Mr. Raskin, chairman of the Committee on Title IV for the Association of Private Pension and Welfare Plans.

STATEMENT OF RICHARD S. RASKIN, CHAIRMAN, COMMITTEE ON TITLE IV OF ERISA, ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC., AND CONSULTING ACTUARY, THE WYATT CO.

Mr. RASKIN. Thank you, Mr. Chairman. I, too, will shorten my remarks in view of the time.

The first thing I want to say is that despite Mr. Gibbons' self-doubts, I believe that American industry views the creation of the Pension Benefit Guaranty Corporation and the insurance system it provides as a necessary addition to the private pension system.

Plan sponsors can now creditably promise that basic benefits will be paid to their employees regardless of the fortunes of their plans or of the sponsors. The PBGC, as a guardian of the insurance system, has an interest in preventing abuse of the system, and we share the interest that the PBGC has in preventing the abuse.

We believe, however, that there are other objectives which must be kept in mind. One is to keep the system from imposing unnecessary hardships on normal commercial transactions. The other is to continue and encourage the continuation of defined benefit plans.

The APP has presented its view on the changes needed in the insurance system in several forms. We continue to believe that reforms are needed to prevent potential abuse of the system, but then those reforms must not impose undue hardship on these transactions and the continuation of plans.

As the guardian of the insurance system, the PBGC has not always adhered to the view that we supporters of the pension system espouse, that their job first is to support the pension system, not only the insurance system, in the pension system.

At the present time there is no bill that has been introduced in a form which both satisfies the PBGC in that it will prevent stringent abuse of the system and plan sponsors and that will not be so intrusive as to prohibit ordinary business transactions.

We hope that conferences between the PBGC and the business groups and the other groups and the legislative bodies will have that happen, but as of now, there is no bill on the floor or introduced in any house in its present form that will satisfy those objectives of all the parties.

The association believes the \$7 premium without reform is unreasonable and excessive and will be a disincentive for finding a legislative solution that would prevent the dumping of unfunded liabilities on the system.

With reform, a \$6 premium is more suitable than a \$7 premium.

We share the difficulty that you and others have had in understanding the numbers supplied by the PBGC. We would like to point out that the PBGC determines its own losses. In 1982, immediate annuities were valued by the PBGC using interest rates as varied from 2.25 to 11 percent, while the Federal Government in that year issued 20-year bonds with extended yields between 10.62 and 14.57 percent.

Obviously, the losses of the PBGC would have been lower had it assumed the higher yields.

Even if we are to accept the PBGC estimate of its 1982 losses as reasonable, a \$6 dollar premium is sufficient. We believe there is a 75-cent overstatement in the future service cost having to do with extending the projection time. This comes from the PBGC's own numbers.

There is also a 25-percent overstatement in the past service component of the figures. This is because the PBGC has somehow equated the payment of \$2 per year for 5 years to a payment of \$1.50 a year for 10 years. Our arithmetic would indicate that at reasonable interest rates, in the 10 to 12 percent area, only \$1.25 are required.

In short, we believe a premium of not in excess of \$6 should become effective as of January 1, 1984, provided it is acted upon

quickly. Employers should have been notified that the 1984 premium will be increased prior to 1984. Most concerned employers were on notice that a \$6 premium was a likelihood and would not view a \$6 premium effective in 1984 as retroactive if immediately enacted into law.

However, there was not reasonable notice to support a higher premium commencing in 1984. A \$7 premium would have a negative impact on how employers view the private pension system. Such a negative impact would be particularly unfortunate at this time.

Mr. Chairman, thank you for allowing us to appear before you today. I will be pleased to answer any questions that you may have. [The prepared statement follows:]

STATEMENT OF RICHARD S. RASKIN, ON BEHALF OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, INC.

Mr. Chairman and members of the subcommittee, my name is Richard S. Raskin; I am a consulting actuary in the New York office of the Wyatt Company. I am also Chairman of the Association of Private Pension and Welfare Plans, Inc. [APPWP] Committee on Title IV of ERISA, and it is in that capacity that I am here today. The APPWP is a non-profit organization founded in 1967 with the primary goal of protecting and fostering the growth of this country's private benefits system. The Association represents over 450 organizations located across the United States. Our member firms include hundreds of plan sponsors—both large and small employers alike. Additionally, our membership included leading organizations from every element of the employee benefits community which support the nation's private benefits system: investment firms, banks, insurance companies, accounting firms, actuarial and benefit consulting firms and various others associated with employee benefit plans. Collectively, APPWP's membership is involved directly with the vast majority of employee benefit plans maintained by the private sector.

American industry views the creation of the Pension Benefit Guaranty Corporation [PBGC] and the insurance system it provides as a necessary addition to the private pension system. Now, plan sponsors can creditably promise that basic benefits will be paid to their employees regardless of the fortunes of the plans or their sponsors. While the PBGC provides a guarantee of benefits to plan participants, it should not be thought of as an insurance company. Rather it is simply a transfer agent providing a mechanism for stronger employers to assure that the benefits promised by failing companies with insufficient plans will be paid. The PBGC often characterizes itself as an insurance company to justify positions it takes with respect to proposed legislation. It is not an insurance company. Unlike insurance companies, it does not have to compete with others in the marketplace or convince prospective purchasers of insurance that the purchase of coverage is financially desirable. The PBGC is the administrator and guardian of the plan termination insurance system.

The PBGC, as guardian of the insurance system, has an interest in preventing its abuse. We share this interest of the PBGC in preventing abuse of the system. We believe, however, that there is another objective which is to keep the system from imposing unnecessary hardships on normal commercial transactions.

The APPWP has presented its view on the changes needed in the Title IV insurance system in several forums. We continue to believe reforms are needed to prevent potential abuse of the system but that those reforms must impose undue hardships on normal commercial transactions. As the guardian of the insurance system, the PBGC has not always adhered to this view which we as supporters of the pension system espouse.

We, with others, believe the goal of fixing the insurance system without damaging the pension system can be achieved by four specific steps:

1. Maintenance of the financial integrity of the system through reasonable prospective increases in the premium.
2. Prevention of potential abuse to the system by prohibiting solvent plan sponsors from dumping unfunded liabilities or spinning off underfunded plans to poorly capitalized purchasers.

3. Encouragement of plan sponsors to add new plans or improve existing ones by enabling them to satisfy their pension obligations by funding accrued vested benefits.

4. Providing clearly defined situations of hardship under which the termination insurance would become operative.

At the present time no bill has been introduced which both satisfies the PBGC, in that it will be sufficiently stringent to prevent abuse, and plan sponsors, in that it will not be so intrusive as to prohibit ordinary business transactions. While industry and PBGC seek a mutually satisfactory solution in curbing abuses, we believe that the financial integrity of the pension system can be maintained by a reasonable prospective increase in the premium.

The APPWP believes a \$7 premium is unreasonable and excessive, and will be a disincentive for finding a legislative solution that would prevent the dumping of unfunded liabilities on the system.

There are several reasons, however, that a \$6 premium is more suitable than a \$7 premium.

First, a review of the PBGC's own figures (contained in the Summary of Basis for a \$7 premium for the Single-Employer Basic Benefits Insurance Program) comparing the current request to the May 1982 request shows a remarkable increase in the component of the PBGC premium request to finance expected future claims from \$3.00 to \$4.50. This 50-percent increase is rationalized by two factors: (1) an increase of about 25 percent to cover fiscal 1982 claims expenses and (2) another 25 percent for the averaging of claims over a later and longer period of time. It should be understood that the PBGC determines its own losses. In 1982, immediate annuities were valued by the PBGC using interest rates which varied from 10.25 to 11.00 percent while the Federal Government in that year issued 20-year bonds with expected yields between 10.62 and 14.57 percent. Obviously its losses would have been lower had the PBGC assumed a higher yield.

Even if we are to accept the PBGC estimate of its 1982 loss as reasonable, it would appear that a 25-percent increase in this component of the premium would be more than sufficient. However, the additional 25 percent for the average of annual claims in the future is not supported by any data and produces a 75-cent overstatement in the premium. A 50-percent increase in this position of the premium is clearly unreasonable and will preclude the possibility of ever achieving a legislative solution for curbing abuses in the system.

Second, that portion of the current \$7 premium request to retire the deficit is \$1.50 amortized over a 10-year period. In the May 1982 premium request of \$6, \$2 was attributed to this portion of the premium amortized over a 5-year period. A simple analysis of this data will reveal that PBGC has also exaggerated this portion of their premium request.

Standard compound interest tables at 11 percent tell us that a deficit which can be retired in 5 years at \$2 can also be retired in 10 years at \$1.25. It is only when interest rates get to about 25 percent that a \$2 payment for 5 years requires a \$1.50 payment for 10 years. Using reasonable interest rates, there is, at a minimum, a 25-cent overstatement in the past service component of the premium increase. Furthermore, there is no reason the past service component needs to be amortized over 10 years. Plan sponsors are required to amortize past service losses over 15 years under ERISA pension plans. If PBGC was required to use a 15 year period, this portion of the premium would be overstated by more than 25-cents. Allowing for a 10-year amortization period, the current PBGC premium request of \$7 is still overstated by 75 cents in the future service component and 25 cents in the past service component, for a \$1 total. This justifies a \$6 premium.

We believe a premium of not in excess of \$6 should become effective as of January 1, 1984, provided it is acted upon quickly. Employers should have been notified that their 1984 premium will be increased prior to 1984. However, most concerned employers were on notice that a \$6 premium for 1984 was a likelihood and would not view a \$6 premium effective in 1984 as retroactive if immediately enacted into law. However, there was not reasonable notice to support a higher premium commencing in 1984. A \$7 premium would have a negative impact on how employers view the private pension system. Such negative impact would be particularly unfortunate at this time.

Mr. Chairman, thank you for allowing us to appear before you today and we will be pleased to answer any questions that you may have.

Chairman RANGEL. I was trying to get staff to help me to determine who your clients were. You actually present these programs to employers to adopt, or your association does?

Mr. RASKIN. The association is an association of employers and insurance companies, actuaries, banks, accounting firms who work on pension plans, who sponsor them.

Chairman RANGEL. So theoretically, I can understand that you would have a purist's point of view in terms of what you think is best for the ideal pension plan. But, we have to deal with employers, with union people, and with the Corporation. I suspect that all of these people would be going to members of your association to ask them for guidelines and direction on what is best for their people, whether they are employers or employees.

Mr. RASKIN. We are an association that largely has employers as the main constituent, and has also on it people who work for employers.

Chairman RANGEL. But, well, suppose we wanted to support your position. Would we have any idea who these employers are, so that we can say to them that this is what your association supported before our committee and this is what you got?

Mr. RASKIN. The names of companies?

Chairman RANGEL. I do not know. It is just that I am not that personally familiar with your association.

Mr. RASKIN. United Technologies, Mobil Oil.

Chairman RANGEL. Are they also in the membership of the National Association of Manufacturers, as I would assume?

Mr. RASKIN. We have small businesses such as the National Association of Automobile Dealers.

Chairman RANGEL. But this is the position that your membership supports?

Mr. RASKIN. That is correct.

Chairman RANGEL. You do not have any problem sharing your membership with us? I mean, not that I am asking for it.

Mr. RASKIN. We can give you a list of the names of the members, if that would be helpful, yes. I have no objection.

Chairman RANGEL. Well, the problem is that we are trying to work out a consensus here that everybody cannot be happy with completely, but certainly one that all would feel that the Congress did try to respond to a very serious present crisis, knowing that we have to move and do something. Now, you have presented some very expert testimony on reservations you have.

However, I do not see how we can accommodate a nonprofit association without being able to identify who agrees with you. So while I am not asking formally for it, I think it would be helpful to all—I think your testimony makes a lot of sense—if you could associate with it the membership. This would show or at least, if they agree with the NAM, or with the Chamber of Commerce, that we have not done violence to your constituency.

There is a difference, I think.

Mr. RASKIN. I think in all of those organizations there is a lot of overlap and there is some difference. I will be glad to give you a list of the members of the association.

Chairman RANGEL. It is not that I need it, but I do think that it would make the record a little clearer. And I apologize, because I should know and I just do not.

[The following was subsequently received:]



March 20, 1984

The Honorable Charles B. Rangel
2330 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Rangel:

It was a great pleasure to have the opportunity to appear before you today. At the hearing you indicated that you were not familiar with the Association of Private Pension and Welfare Plans (APPWP).

The APPWP is a non-profit organization founded in 1967 with the primary goal of protecting and fostering the growth of this country's private benefits system. The Association represents over 450 organizations located across the United States who employ over 5,000,000 people. Our member firms include hundreds of plan sponsors--both large and small employers alike. Additionally, our membership includes leading organizations from every element of the employee benefits community which support the nation's private benefits system: investment firms, banks, insurance companies, accounting firms, actuarial and benefit consulting firms and various others associated with employee benefit plans. Collectively, APPWP's membership is involved directly with the vast majority of employee benefit plans maintained by the private sector. I have enclosed a membership list.

The Association has worked with you in the past. You were a speaker at our last Annual Meeting in May of last year. Both Ed Davey, our current Executive Director and Jeff Hart, his predecessor have worked with you and your staff on specific benefit legislative issues. You have already met with a number of our New York members. We would like to get together with you again. I will contact you shortly to see if we can arrange a convenient time and place.

Sincerely,

Richard S. Raskin
Chairman
Single Employer Insurance Committee

RSR:sr
Enclosures

APPWP

Association of Private Pension and Welfare Plans

MEMBERSHIP BY INDUSTRY

ACCOUNTING FIRMS

Arthur Andersen & Company
Coopers & Lybrand
Deloitte, Haskins & Sells
Fox & Company
Peat, Marwick, Mitchell & Co.
Price Waterhouse
Touche Ross & Company

BENEFIT CONSULTING AND ADMINISTRATION FIRMS

A.S. Hansen, Inc.
Alexander & Alexander, Inc.
American Retirement Systems
Beyer Barber, Inc.
BFN Corporation
Booke and Company
Bryan, Pendleton, Swats, et al.
Corroon & Black Benefits, Inc.
CPI Pension Services
Edward Price Company
ERISCO, Inc.
FBA Insurance Trust
Findley, Davies & Company
Follen, Jackson & Co.
Frank B. Hall Consulting Company
Frank Russell Company, Inc.
Geo B Buck Consulting Actuaries Inc
Gradison & Company, Inc.
Hazlehurst & Associates, Inc.
Herbert L. Jamison & Company
Hewitt Associates
Higgins Associates
Hooker & Holcombe, Inc.
Howard Johnson & Company
Huggins & Company
Hutchison & Associates, Inc.
J.J. Benepak
Johnson & Higgins
Kwasha Lipton
Laiken, Siegel and Co.
Lambert M. Huppeler Company, Inc.
Leggette & Company, Inc.
Leo Burnett Company, Inc.
Martin E. Segal Company
McCreedy and Keene, Inc.
Meidinger, Inc.
Milliman & Robertson, Inc.
Noble Lowndes International, Inc.
Nyhart Company, Inc.
Ostheimer & Company, Inc.
Pension Associates, Inc.
Pension Consultants, Inc.

Pension Planning Company, Inc.
Planning Counselors, Inc.
Robert M. Epler Company, Inc.
Schwarz, Shera & Associates
Stone, Young & Company
Thomas E. Cummins, Consultants
Tillinghast, Nelson & Warren
Towers, Perrin, Forster & Crosby
Waterfield & Company
Watkins, Ross, Stanar & Lamps
Werntz & Associates, Inc.
William M. Mercer, Incorporated
William M. Troyan, Inc.
Willse & Associates, Inc.
Wyatt Company

COMMERCIAL BANKS

American National Bank and Trust
American Trust Company of Hawaii
Bank of Blountsville
Bank of Oklahoma, N.A.
Bank of Virginia
Bankers Trust Company
Center Trust Company of St. Louis
Citibank, N.A.
Citizens & Southern National Bank
Citizens Fidelity Bank & Trust
Connecticut Bank & Trust Company
Connecticut National Bank
Continental Illinois National Bank
Farmers Bank & Trust Company
First & Merchants National Bank
First Interstate Bank of Washington
First National Bank of Atlanta
First National Bank of Birmingham
First National Bank of Morton
First State Bank & Trust Company
First Wisconsin Trust Company
Gillett State Bank
Girard Bank
Harris Trust and Savings Bank
Hawaiian Trust Company, Ltd.
InterFirst Corporation
Le Mars Savings Bank
Manufacturers Hanover Trust Company
Marine Midland Bank, N.A.
North Carolina National Bank
Northern Trust Company
Old Kent Bank & Trust Company
Republic Bank of Oak Cliff
RepublicBank Dallas
South Carolina National Bank
United Virginia Bank
Virginia National Bank

DIVERSIFIED FINANCIAL FIRMS

American Express Company
Chicago Title and Trust Company
Decatur Federal Savings & Loan
Merrill Lynch
Metropolitan Saving & Loan Assn
Walter E. Heller International

INDUSTRIAL FIRMS

Abarta, Inc.
Adolph Coors Company
AeroJet General
Allegheny International, Inc.
Allied Corporation
Aluminum Company of America
American Can Company
American Liberty Oil Company
American Standard, Inc.
Appleton Mills
ARMCO, Inc.
Arrow Aluminum Castings Company
Atlantic Richfield Company
B. Green & Company, Inc.
Barnes Group
Baxter Travenol Laboratories, Inc.
Beatrice Foods Company
Binney & Smith, Inc.
Boeing Company
Boise Cascade Corporation
Bristol-Myers Company
Broan Manufacturing Company
Brunswick Corporation
Carolina Steel Corporation
Casio, Inc.
Ceco Corporation
Celeron Corporation
Central Soya Company, Inc.
Coca-Cola Bottling Company of N.Y.
Combustion Engineering, Inc.
Copley Newspapers
CPC International, Inc.
Dana Corporation
Deere & Company
Diamond Shamrock Corporation
Digital Equipment Corporation
Dolly Toy Company
Dover Corporation
Dozier Company
Dresser Industries, Inc.
E.I. du Pont de Nemours & Company
E.W. Scripps Company
Eastman Kodak Company
Ethyl Corporation
Exxon Corporation
Farmland Industries, Inc.
Franklin Electric Company
Froehling & Robertson, Inc.
G.A. Wintzer & Son Company
Gast Manufacturing Corporation

Gates Learjet Corporation
GATX Corporation
General Foods Corporation
General Tire & Rubber Company
Hallmark Cards, Inc.
Heublein, Inc.
Hillyard Chemical Company
Hughes Aircraft Co.
Ingram Corporation
J.G. Boswell Company
Kendall Company
L.M. Berry and Company
Litton Industries
Lone Star Steel Company
Lorranger Plastics Corporation
MacDermid, Inc.
Manville Corporation
Mercedes-Benz of North America
Mine Safety Appliances Company
Mobil Oil Corporation
Monroe Publishing Company
Mrs. Baird's Bakeries, Inc.
National Manufacturing Company
Noble Drilling Corporation
Northrop Corporation
O'Neill Properties, Ltd.
Old Northwest Company Associates
Owens-Corning Fiberglass Corp.
Paducah Newspapers, Inc.
Pensions & Investment Age
Pepsi-Cola Bottling of Tampa
Pepsico, Inc.
Philip Morris Incorporated
Phillips Petroleum Company
Pogo Producing Company
Providence Journal Company
Purity Dairies, Inc.
Ransburg Corporation
Reading & Bates Corporation
Robertshaw Controls Company
Rockwell International Corporation
Ross Roy, Inc.
Sabine Corporation
SCM Corporation
Sprague Electric Company
Sun Company, Inc.
Tektronix, Inc.
Texas Farm Products Company
Texas Industries, Inc.
Texas Instruments, Inc.
Thermo Electron Corporation
U.S. News and World Report
United Technologies Corporation
W.R. Grace & Company
Walling Company, Inc.
Warner Communications, Inc.
Webcrafters, Inc.
Weyerhaeuser Company
White Castle System, Inc.
Williams Steel and Hardware
Wm. Wrigley Jr. Company

INSURANCE COMPANIES

Aetna Life and Casualty Company
 American Family Insurance Group
 Atlantic Fidelity Life Insurance Co
 Bankers Life Company
 CNA Insurance Companies
 Connecticut General Life Insurance
 Employers Casualty Company
 Equitable Life Assurance Society
 Great-West Life Assurance Company
 Iowa National Mutual Insurance Co.
 John Hancock Mutual Life Insurance
 Massachusetts Mutual Life Insurance
 Metropolitan Life Insurance Company
 Mutual Benefit Life
 National Life Insurance Company
 New England Mutual Life Insurance
 Prudential Insurance Company
 Safeco Life Insurance Company
 Transamerica Life Insurance Company
 Travelers Insurance Company
 Union Labor Life Insurance Company

INVESTMENT ADVISORY AND
MANAGEMENT FIRMS

Allen & Associates Investment Mgmt.
 Alliance Capital Management Corp.
 Bancor Mortgage Company
 Bank of America
 Boyle Investment Company
 City Investing Company
 Cole, Yeager & Wood, Inc.
 David L. Babson & Company, Inc.
 Delaware Investment Advisers
 Discount Corp. of N.Y. Advisors
 Fayed Serofim and Company
 First Investment Management Corp.
 Fred Alger & Company, Inc.
 IDS Trust Company
 Institutional Capital Corporation
 M.D. Sass Associates
 Macay-Shields Financial Corp.
 Massachusetts Financial Services Co
 McGlinn Capital Management, Inc.
 Mitchell Hutchins Investment Adv
 Olympic Partners
 Prudential Mortgage Bankers
 Reimer & Koger Associates, Inc.
 Safeco Asset Management Company
 Starwood Corporation
 Stralem & Company, Inc.
 T. J. Holt & Company, Inc.
 Thorndike, Doran, Paine & Lewis
 Todd Investment Advisors, Inc.
 Trust Company of the West
 Wilke International Corporation

LAW FIRMS

Caplin & Drysdale, Chartered
 Conahan & Conahan, AAL, ALC
 Covington & Burling
 Cummings and Kershaw, P.C.
 Durant, Mankoff, Davis, et al.
 Ewen, Mackenzie & Peden, PSC
 Faegre & Benson
 Finley, Kumble, Wagner, & Heine
 Foley & Lardner
 Forster, Gemmill & Farmer
 Gardere & Wynne
 Greenebaum, Doll & McDonald
 Hale, Russell & Gray
 Johnson & Swanson
 Kirkland and Ellis
 McDermott, Will & Emery
 Miller & Chevalier, Chartered
 Montgomery, McCracken, Walker, etc.
 Murray, Shardlow & Budzyn
 Patterson, Belknap, Webb, & Tyler
 Patton, Boggs & Blow
 Pepper, Hamilton & Scheetz
 Porter & McKinney
 Pullman, Comley, Bradley & Reeves
 Reid & Reige, P.C.
 Robinson, Robinson & Cole
 Rogers & Wells
 Ryley, Carlock & Ralsion
 Seifman, Semo & Slevin, P.C.
 Shipman & Goodwin
 Simon, Twombly & Terry, P.C.
 Solomon, Rosenbaum, Drechsler, etc.
 Steptoe & Johnson, Chartered
 Strasburger & Price
 Waldman & Guarisco
 Warner, Norcross & Judd
 White & Case
 Winston & Strawn

NONPROFIT ORGANIZATIONS

American College of Obstetricians
 American Mining Congress
 American Trucking Association, Inc.
 Ancilla Domini Health Services
 Blue Cross & Blue Shield Assn
 Blue Cross & Blue Shield of N.Y.
 Copper Development Association, Inc
 Food Marketing Institute
 Graphic Arts International Union
 Holy Cross Shared Services, Inc.
 League of Voluntary Hospitals
 NADART
 Palmer College Foundation
 Pennsylvania Mun. Retirement Board
 Plumbers Local 690 Industrial Funds
 Seafarers Welfare & Pension Plan
 UIU Pension Trust
 Wholesaler-Distributors Trust

RETAIL FIRMS

Great A & P Tea Company, Inc.
Jewel Companies, Inc.

SERVICE FIRMS

Agri Industries Retirement Plan
American Medical International
Brooks Armored Car Services
CBS, Inc.
Charles E. Virgin, M.D., P.A.
Clinical Radiologists, S.C.
Holiday Inns, Inc.
Humana, Inc.
IU International Management Corp.
Medical Center Clinic
Newport Sales Company, Inc.
Oklahoma Allergy Clinic, Inc.
Orthopaedic Surgeons, P.C.
Phibro-Salmon, Inc.
Washington Athletic Club

TRANSPORTATION COMPANIES

Chessie System Railroads
Denver & Rio Grande Western R.R.
DSI Transports, Inc.

UTILITIES

American Telephone & Telegraph, Inc.
Ameritech
Boston Edison Company
Boston Gas Company
Central & South West Corporation
Consolidated Natural Gas Service
East Texas Salt Water Disposal
GTE Corporation
Middle South Services, Inc.
Public Service Company of Colorado
Texas Eastern Transmission Corp.
United Telecommunications, Inc.
Valero Energy Corporation

Chairman RANGEL. Mr. Hacking, American Association of Retired Persons.

STATEMENT OF JAMES HACKING, ASSISTANT LEGISLATIVE COUNSEL, AMERICAN ASSOCIATION OF RETIRED PERSONS, ACCOMPANIED BY PETER TROZINSKI, AARP POLICY ANALYSIS STAFF

Mr. HACKING. Thank you, Mr. Chairman. On my left and accompanying me is Mr. Peter Trozinski, who is a member of the AARP policy analysis staff.

I will submit the association's statement for the record and keep my remarks as brief as possible.

Given the size of the PBGC's accumulated deficit, AARP supports increasing the single employer insurance premium rate to \$7 per participant per year. The rate of increase, both in number and size, of new claims has greatly exceeded the levels expected when the current premium rate of \$2.60 was set in 1978.

The present value of the Corporation's liabilities has grown to over \$1.5 billion. The deficit at the end of 1984 is expected to be \$400 million. The PBGC projects that, absent an increase in the premium, the deficit will accumulate to over \$600 million by 1986.

An increase in the single employer insurance premium to \$7 in our view should not only alleviate the Corporation's current financial dilemma, it should also forestall the need for future and even larger premium increases.

While the insurance premium rate should be increased now, there are other problems that should be addressed at the same time. For one thing, the problem of dumping must be addressed. One possible solution would be to eliminate the 30 percent of net worth ceiling and allow the PBGC to pursue its claims against a sponsor as an unsecured creditor. A second approach would be to tighten the rules which allow plan sponsors to terminate their plans.

A second problem which must be addressed has to do with the waiver provisions under ERISA. Although the IRS has begun to grant annual contribution waivers to plan sponsors, conditional on the plan's continuance, the fact remains that the number and dollar amount of waivers granted has been increasing at a very rapid rate.

A possible solution would be to authorize the PBGC to place conditions on funding waivers. The PBGC could also be allowed to place a lien on the employer's assets at the time the waiver is granted. Alternatively, PBGC could be given a future profits interest in ongoing employers.

In conclusion, Mr. Chairman, the AARP believes that the PBGC is in very serious financial trouble. Because of the critical role played by the Corporation in providing pension security for present and future retirees, we think H.R. 3930 is essential legislation.

While this legislation may not address all the issues that could potentially be addressed, like the pension reversion issue for example, it at least does represent a first good step.

That concludes our remarks.

[The prepared statement follows:]

STATEMENT OF JAMES HACKING, ON BEHALF OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS

I. INTRODUCTION

My name is James Hacking and I am appearing today on behalf of the nearly 16 million members of the American Association of Retired Persons, the nation's largest aging organization. The Association appreciates the opportunity to appear before the Oversight Subcommittee to support the proposal that Congress increase the single employer insurance premium rate from \$2.60 to \$7.00 per participant per year. Given the size of PBGC's accumulated deficit, it is vital to the interest of all defined benefit plan participants that the Corporation be placed on sound financial grounds. As increase in the insurance premium to \$7.00 is therefore necessary in order to eliminate the Corporation's accumulated deficit.

II. BACKGROUND

There are currently over 28 million workers participating in single employer defined benefit plans guaranteed by the PBGC. These workers are assured that in the event their pension plan terminates with insufficient assets to pay guaranteed benefits, the PBGC would step in as plan trustee, and provide participants with at least a substantial portion of their pension benefits. While only a small percentage of these participants will ever require the financial assistance of PBGC, the insurance it provides to all is invaluable. Current retirees who are paid benefits directly by the Corporation are even more cognizant of the essential service PBGC provides.

The PBGC finances the insurance plan primarily through premiums paid by ongoing plans. The current premium rate of \$2.60 per year was set in 1978 in the belief that it would provide sufficient revenues to meet future obligations from terminated plans. However, the rate of increase in both the number and size of new claims greatly exceeded predicted levels creating a sizeable deficit. Benefit payments have increased to an annual rate of over \$150 million, up from \$100 million one year ago. The PBGC projects that by the end of 1985, 90,000 beneficiaries will receive payments, compared to 75,000 beneficiaries in 1983. The present value of the Corporation's liabilities has grown to over \$1.5 billion which, when compared with PBGC's assets of \$1.1 billion, leaves a deficit of over \$400 million for 1984. PBGC projects that, absent an increase in the premium, the deficit will be over \$600 million by 1986. While there are sufficient assets to maintain benefit payments to participants in the short term, there is the risk that absent Congressional action, the PBGC will become a pay-as-you-go entity, which over time will be unable to meet its obligations.

III. CONGRESS MUST ACT QUICKLY

This situation is not a new one. Congress recognized the serious problem of the Corporation's deficits and made efforts to restore solvency to the system in H.R. 3930 and S. 1227. Both bills called for an increased premium of \$6.00, effective January 1983. Had the premium been raised as of January 1983, the Corporation's deficit would have been amortized over a five year period. No final action was taken, however, and the accumulated deficit grew by an additional \$100 million between 1981 and 1982. It was projected that a \$6.00 premium effective January 1984 would require 15 years to fully amortize the deficit.

As we now approach the end of the first quarter of 1984, PBGC has acquired funding obligations so large that an increased premium of \$6.00 will not provide revenues sufficient to reduce the deficit. Congress was warned of this possibility by the GAO which, in its November 1983 report on the need to strengthen the PBGC, stated that "a substantially larger increase than the \$6.00 premium rate would ultimately be needed if the current rate increase request is not granted". In failing to act earlier, Congress has made it necessary for the PBGC to seek a higher premium.

An increase in the single employer insurance premium to \$7.00 not only would alleviate the Corporation's current financial dilemma, it would also forestall the need for future premium increases. AARP is cognizant of the fact that at some level, high insurance premiums may discourage the continuation and adoption of these insured private pension plans. The necessary increase now will prevent greater, and potentially more detrimental, increases at a later date.

IV. OTHER LEGISLATIVE CHANGES NECESSARY TO PREVENT ABUSES

While increasing the insurance premium would be a major step toward restoring solvency to the program, there remain defects in the system which should be cor-

rected. First, there is the problem of plan sponsors "dumping" unfunded pensions on the PBGC. Under current law, any employer may voluntarily terminate an underfunded pension plan and shift the responsibility for paying guaranteed benefits to the PBGC. The extent of the sponsor's liability to the Corporation is limited to thirty percent of the sponsor's net worth. For employers with high unfunded liabilities and little or no net worth, this option is financially attractive.

These terminations place a burden upon the PBGC because the amount recoverable from sponsors whose net worth is low does not come close to meeting the unfunded obligation, the difference being made up by PBGC. Thus, a sponsor may terminate a plan with little or no liability, and, having relieved itself of a major obligation, continue in business. One possible solution would be to eliminate the thirty percent of net worth ceiling, and allow the PBGC to pursue its claims against a sponsor as an unsecured creditor. This approach would enable the PBGC to recover in many cases a greater percentage of a plan's unfunded benefits than it does at present. A second approach would be to tighten the rules which allow plan sponsors to terminate their plans.

A second problem which must be addressed is contained within the waiver provisions of ERISA. Under present law, a plan sponsor which demonstrates that it cannot make required minimum funding contributions to its pension plan may receive a one-year waiver from the IRS. No more than five waivers are permitted in a fifteen year period. While the PBGC benefits when a plan sponsor recovers its economic health and is able to repay the waived contributions, a sponsor may terminate a plan with sizeable unpaid contributions. When this occurs, the PBGC negotiates with the sponsor to recover as much of the unpaid portion as possible. The IRS has been sensitive to this issue and has begun to grant waivers conditional on the plan's continuance. However, the number and dollar amount of waivers granted has been increasing at an alarming rate. This, coupled with the fact the PBGC's claims against a plan which violates its conditional waiver are grouped with other general unsecured creditors means that the PBGC may soon face additional liabilities with little or no recovery from sponsors. A possible solution to this problem would be to authorize the PBGC to place conditions on funding waivers. The PBGC could also be allowed to place a lien on the employer's assets at the time a waiver is granted. Should the plan terminate, the PBGC would collect more than it could as a general unsecured creditor. Alternatively, the PBGC could be given a future profits interest in ongoing employers.

V. CONCLUSION

The Association believes that there exists a serious threat to the financial viability of the Pension Benefit Guaranty Corporation. Because of the critical role played by the PBGC in the retirement income scheme, action to protect the Corporation must be taken soon. AARP hopes to be able to continue working with the Subcommittee in support of its effort to enact legislation that would improve the ability of the PBGC to protect pension plan beneficiaries.

Chairman RANGEL. We thank you very much. We thank the panel for their patience in waiting so long to testify, and especially with the understanding that we can look forward to your cooperation in the future. The legislation is far too fluid, I think, for us to be locked in; but, the Congress and the chairman of the full committee do recognize the urgency of the Congress responding to this crisis. And so does the administration.

So I am hopeful that you will continue to work with the Education and Labor Committee, as we will, and that we can get a bill out as soon as possible.

Thank you very much.

The subcommittee stands adjourned until tomorrow at 10, when we will be discussing health matters.

[Whereupon, at 1:55 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

STATEMENT OF THE AMERICAN ACADEMY OF ACTUARIES

The American Academy of Actuaries is a professional organization which includes among its membership more than 7,000 actuaries who work in all areas of actuarial

science. Our members are employed by insurance companies, consulting firms, government agencies, academic institutions, and as individual practitioners. A large proportion of our membership is actively involved in pension matters, and are enrolled actuaries under ERISA.

The Academy's Pension Committee is composed of several major subcommittees, and the Subcommittee on PBGC (Single Employer Plans) which is submitting this statement is assigned the responsibility of offering guidance and counsel to governmental bodies on matters which concern the operation of single employer pension plans and the Pension Benefit Guaranty Corporation. As such, it must be stressed that the views expressed herein are those of the Academy subcommittee, and are independent of views which might otherwise be expressed by a particular trade group.

We understand that the Subcommittee on Oversight is considering the propriety of the Administration's proposal to increase the current premium rate charged by the PBGC from \$2.60 to \$7.00 per year per participant. Our major recommendation in this regard is to urge that the Subcommittee defer consideration of any such increase until such time as proposed changes to the program elements of the single employer program are fully discussed and decided upon. In our view, any insurance program, be it private or public in nature, has a design feature as well as a pricing feature. To the extent that design changes are being considered, we deem it inappropriate to consider price changes until the design changes are settled, because the extent of any price change must necessarily relate to the program design elements.

We recognize that at the present time there is a projected financial deficiency in the PBGC single employer program. We are concerned that the analysis utilized in formulating the PBGC estimates was primarily economic in nature, and was not undertaken through a rigorous actuarial methodology. We would be much more willing to comment on the reasonableness of the estimate (and hence to the premiums increase being sought) had a thorough actuarial analysis been performed. In this context, it is useful to note that virtually all insurance company annual valuations which may be required by state law require on actuarial valuation of reserves, anticipated expenditures, and projected revenues. We would therefore urge that Congress seriously consider amending legislative proposals currently being considered (e.g., H.R. 3139) to require an annual actuarial statement on the PBGC's financial reports, together with an actuarial analysis on the propriety of the premium rate.

Our second concern is that, while a premium increase attempts to restore financial stability, this action may have the opposite effect, and further thwart the achievement of national retirement income goals. The increase in premium rate may trigger additional plan terminations from marginally funded plans, causing PBGC's unfunded liabilities to grow beyond predicted levels.

Even soundly funded plans may terminate, in exchange for a less burdensome defined contribution approach. Organizations without existing retirement plans will be dissuaded from establishing defined benefit plans because of the onerous requirements, including the \$7.00 premium rate. The end result would be that more, not fewer American workers will be deprived of the guaranteed retirement income levels which only defined benefit plans can provide.

At the present time, as you are aware, many basic changes to the single employer program administered by PBGC are under consideration. We believe that these changes, if enacted, would have a direct impact on the level of premium needed to adequately fund PBGC operations in future years. Hence, we strongly recommend

that Congress consider the entire program before taking action in the single area of premium levels.

We thank you for the opportunity of submitting this statement, and offer our assistance in further deliberations on this and related subjects.

Pension Committee: Williard A. Hartman, Chairman.

Subcommittee on PBGC (Single Employer Plans): Peter A. Bleyler, Chairman; Marc M. Twinney, Vice Chairman; Robert B. Aglira; Darrel J. Croot; Joseph H. Dittmer; Edward N. Fleischer; Michael J. Gulotta.

STATEMENT OF THE AMERICAN RED CROSS

Mr. Chairman and distinguished members of the Subcommittee. We appreciate this opportunity to present our views on the topic of this hearing, increased premium payments to the Pension Benefit Guaranty Corporation, and to ask your support in exempting the American Red Cross Retirement System from coverage under Title IV of the Employee Retirement Income Security Act of 1974 (ERISA). Such an exemption for the Retirement System is already contained in H.R. 3930 (enclosed). If the premium increase contained in H.R. 3930 or similar legislation is enacted without the exemption, any PBGC premium increase will impose unnecessary additional costs on the Retirement System.

The American Red Cross Retirement System is a single-employer defined benefit plan maintained by The American National Red Cross (Red Cross). The Red Cross is a unique organization, chartered by Congress to fulfill the obligations of the United States under the Geneva Conventions as well as to provide other humanitarian aid. Coverage under the PBGC termination insurance program is an unnecessary drain on the resources of the Red Cross, given the financial health of the plan.

The Red Cross was created by Congress in 1900 and reorganized under government supervision in 1905 to fulfill the obligations of the United States as a party to the Geneva Conventions. It is a National Society of the International Red Cross, accredited by the United States and recognized by the International Committee of the Red Cross. By statute, the Red Cross has four major purposes: (1) to furnish aid to sick and wounded members of the armed forces in time of war, in accordance with the Geneva Conventions; (2) to perform the duties of a national society under the Geneva Conventions; (3) to act as a medium of communications between members of the armed forces and their families; and (4) to provide national and international disaster relief. 36 U.S.C. 3 (1980). Although the Red Cross performance of those duties is supported primarily by private donations, it has been treated as a federal instrumentality for a number of purposes, principally exemption from federal and state taxes and state regulatory measures. Because of its importance to the armed forces, the Red Cross is subject to annual audit by the Department of Defense. 36 U.S.C. 6 (1980). (In contrast, "private corporations established under federal law," a category which includes all other organizations whose charters are set forth in Title 36 of the U.S. Code, are subject to private audits. 36 U.S.C. 1101-1103.)

Congress has previously recognized the essential distinction between the Red Cross as an instrumentality of the United States and other nongovernmental charitable organizations. For example, in enacting special tax benefits for organizations that conduct sports programs exclusively for the benefit of the Red Cross (currently section 114 of the Internal Revenue Code), the House Committee on Ways and Means stated:

"The Red Cross has a unique status which clearly differentiates it from other charitable organizations. Congress has conferred on the Red Cross a quasi-governmental status under legislation which sets forth its principal functions and prescribes the organization and methods of operation. Specific duties, such as the furnishing of aid to the sick and wounded of armies in time of war, are imposed upon the Red Cross by statute."

H. Rep. 1728, 82d Cong., 2d Sess. 1-2 (1952). Floor discussions on the same bill indicated that the restriction of the bill to the Red Cross was in accord with prior Congressional action in exempting the Red Cross from federal excise taxes. 98 Cong. Rec. 3909-10 (1952). The American National Red Cross is currently exempt from the excise tax on communications services under section 4253(c) of the Internal Revenue Code.

However, the Pension Benefit Guaranty Corporation determined that the American Red Cross Retirement System is not a "governmental plan" under section 4021(b)(2) of ERISA. Section 4021(b)(2) exempts from Title IV coverage any plan "established and maintained for its employees by the Government of the United States . . . or by any agency or instrumentality of . . . the foregoing." The PBGC based its conclusion on the fact that "the United States [is] not obligated to fund any insufficiency in the plan in the event of its termination." Letter from Henry Rose to George M. Schneider (April 10, 1979), (copy attached).

As a result of the proposed increase in PBGC premiums contained in H.R. 3930, the Red Cross Retirement System faces additional costs of approximately \$85,000 per year (total premiums will be approximately \$144,000 per year). The payment of premiums affords no benefit to the Red Cross or to the participants in the plan because of the continued financial strength of the plan. At the end of the last plan year (June 30, 1983), the value of all accrued benefits was \$275.3 million, vested benefits totalled \$259.0 million, and the fair market value of the plan's assets was \$503.9 million. The actuarial assumptions used in the valuation of the plan are conservative (e.g., an investment return of 7 percent). This serves to overstate the value of benefits (both accrued and vested) and therefore understates the amount by which the value of plan assets exceed the value of plan benefits.

The Retirement System has achieved this level of plan funding by prudent management of assets and benefits policy, combined with a conservative approach to funding the plan. During the last ten years, contributions to the plan have significantly exceeded the actuarially determined accrual rates. The plan has generated a credit balance of \$18.7 million in its minimum funding standard account. The aggregate cost method, used to determine the required contribution under the minimum funding requirements, is itself a conservative method of funding, which spreads the costs of employees' benefits in level amounts over their working careers.

The funding policies of the Retirement System provide more security to plan participants than coverage under the termination insurance provisions of Title IV. The cost of premiums therefore imposes an unnecessary, and growing, cost on the Retirement System that only deflects funds that could otherwise be used to provide Red Cross services to the public or benefits to participants. While we recognize that the nature of the PBGC termination insurance program requires that well-funded plans subsidize poorly-funded ones, the imposition of this additional cost on the American Red Cross only detracts from the purposes for which the Red Cross was chartered by Congress.

We therefore respectfully urge Congress to exempt the American Red Cross Retirement System from coverage under Title IV as provided in H.R. 3930.

Thank you.

[Excerpt from H.R. 3930, 98th Cong., 1st Sess.]

A BILL To amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 to improve the single-employer pension plan termination insurance program, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE AND TABLE OF CONTENTS.

This Act may be cited as the "Single-Employer Pension Plan Amendments Act of 1983".

(C) by adding after paragraph (13) the following new paragraph:

"(14) which is established and maintained by a corporation established by Act of Congress to act in matters of relief under the Treaty of Geneva of August 22, 1964."

"(6) Section 4022(b)(7)(B) (29 U.S.C. 1322(b)(7)(B)) is amended by striking out "following" and inserting in lieu thereof "beginning with".

"(7) Section 4042(d)(3) (29 U.S.C. 1342(d)(3)) is amended by striking out "same duties as a trustee appointed under section 47 of the Bankruptcy Act" and inserting in lieu thereof "same duties as those of a trustee under section 704 of title 11, United States Code".

SEC. 117 EFFECTIVE DATE.

Except as otherwise provided in this Act, the provisions of this Act shall be effective on the date of enactment of this Act.

SEC. 118. AMENDMENTS TO THE TABLE OF CONTENTS OF ERISA.

The table of contents in section 1 is amended—

(1) by striking out the item relating to section 211 and inserting in lieu thereof the following new items:

"Sec. 211 Amendment of single-employer plans to cease benefit accruals allowed only in cases of standard termination.

"Sec. 212. Effective dates.;

PENSION BENEFIT GUARANTY CORPORATION,
Washington, D.C., April 10, 1979.

Mr. GEORGE M. SCHNEIDER,
Secretary and Comptroller,
The American National Red Cross, Washington, D.C.

DEAR MR. SCHNEIDER: This is in response to your letter to this Office raising the question as to whether the Retirement System of the American National Red Cross (the "Plan") is excluded from coverage under Title IV of the Employee Retirement Income Security Act of 1974 (the "Act") as a "governmental plan" within the meaning of Section 4021(b)(2) of the Act.

Section 4021(b)(2) excludes from coverage any plan "established and maintained for its employees by the Government of the United States . . . or by any agency or instrumentality [thereof]." It appears to us that the Plan is not a "governmental plan," and, therefore covered under Title IV of the Act.

Although Congress granted the American National Red Cross (the "Red Cross") its Charter, that fact alone is not determinative of whether the Red Cross is an instrumentality of the United States. We note that the statute creating the Red Cross does not designate it a governmental instrumentality. We note also that a number of federal statutes, e.g., the Equal Employment Opportunity Act of 1972 and the Occupational Safety and Health Act of 1970, treat the Red Cross as a private employer, and that Congress does not appropriate funds for the Red Cross.

There is no evidence that Congress intended to deprive the employees of the Red Cross of the protection of Title IV of the Act. If the United States were obligated to fund any insufficiency in the Plan in the event of its termination, we might well view the situation differently.

Sincerely,

HENRY ROSE, General Counsel.

STATEMENT OF THE AMERICAN RETAIL FEDERATION

This statement reflects the views of the American Retail Federation, the umbrella group representing the U.S. retail industry. ARF is made up of state retail associations in all 50 states and the District of Columbia, and 30 national retail associations.

The Pension Benefit Guaranty Corporation (PBGC) has asked Congress to increase the premium for single-employer pension plans from \$2.60 to \$7.00, effective January 1, 1984. The premium increase was designed to finance an expected increase in the level of claims arising from terminated pension plans, to retire existing deficits over 15 years and to pay administrative costs.

ISSUE ONE

A number of business groups reluctantly concede the need for a small premium increase but contend that a premium increase serves no useful purpose without structural reform in the insurance system. Some of the proposed changes are incorporated in legislation now before the Congress, (H.R. 3930 and S. 1227). Notwithstanding these proposed changes to the ERISA system, the prospects of future premium increases would not be eliminated.

Recent major plan terminations presented the PBGC with an additional continuing liability, increasing the present deficit to \$430 million, almost double the deficit underlying the 1982 requested increase. This situation underscores our concern, and presages more increases in pension premiums. We believe the PBGC deficit will get worse and greater premiums or government intervention will be required. The proposed changes to Title IV of ERISA are commendable but they will not allay the concern with the inequities of the proposed premium increase. We propose two additional changes which will equitably distribute the insurance risk among plan sponsors.

Some pension plan sponsors manage their pension plans with more conservative interest rate assumptions and shorter amortization of past service liabilities. Consequently, benefit costs for current and past service are higher and, thereby the unfunded status of such plans is reduced with concomitant lower insurance risks. It is inequitable that these employer sponsors should also be required to pay the same insurance premium as required of less conservatively managed plans.

Another example of inequitable insurance premiums relates to the retail industry. PBGC benefit guarantees to plan participants do not differentiate between the level of pension benefits payable to drug or chemical workers, for example, as compared to retail store workers. And yet, the average hourly rate for each, on which pension benefits are ultimately based, differ substantially. Here again the risk in a drug or chemical worker plan would be greater because of larger dollar benefits. One would assume, therefore, that the actuarial cost of insuring drug or chemical workers' retirement benefits against insolvency would be greater.

Although the principles dealing with the premium sought by the PBGC use the lexicon of insurance, it occurs that we are really dealing with a social policy of providing guaranteed retirement benefits. There is no quarrel with such a policy, particularly if it is applied consistently, particularly to the funding of plans, interest rate assumptions and amortization of past service liabilities. Actuarial assumptions being what they are, however, it is unlikely that a consensus view could be reached. We believe, therefore, that the better direction in effectuating this policy is to treat PBGC premiums on a risk-related basis.

ISSUE TWO

Regarding the amount of increase requested there are three parts that make up the premium of \$7; administrative expense, retirement of deficit and anticipated future claims.

There is generally no opposition to the one dollar figure identified for administrative expenses.

The two challenges that exist with respect to the requested level of premium are the period of time in which a present "deficit" should be eliminated and the assumptions used by the PBGC which respect to the expectations for future claims.

There is no reason to retire the deficit over a time span such as 15 years. While the policy of the PBGC is to have on hand assets equal to future obligations, that principle would seem unrealistic in today's environment. The obligations that the PBGC have to meet are payable over a very long time horizon, up to 30 years or more when one recognizes that deferred vested benefits are also included in that time horizon. Their stated presumption is that it would be unfair for future premiums to provide the basis for payment of present claims, as stated in their submission to Congress. That logic breaks down when one recognizes that they are willing to have that relationship exist for 15 years. There will always be up and down swings with respect to whether premium dollars are being used for current or past terminations. These swings will be based on economic conditions (i.e. more terminations when in a recession), as well as the long-term implications with respect to defined benefit pension plans and their growth contraction, etc., as the country attempts to evolve a logical national policy with respect to the provision of retirement income.

The amortization of the existing deficit should be over a longer time horizon, such as 30 years. With regard to the assumption used by the PBGC in projecting future anticipated claims, they have not published the basis for these projections and it is

imperative that such be done so that a determination could be made as to their reasonableness. Knowledgeable sources indicate that it is quite possible that current experience with respect to claims has been projected on a straight line basis, which fails to take into account the current economic environment as well as the abuses that are identified with "dumping" on the system. The variables involved are complex and it becomes very difficult to accept on its face the resulting premium basis that they claim is necessary for that.

The PBGC is using an argument that legislative changes are necessary to prevent the abuse of dumping and is claiming that portion of the premium identified for future claims is necessary unless legislative correction is made. They are using this argument as a threat to get the legislation enacted that they are aggressively pursuing. The fear is that we will have a result which is a \$7 premium level and also have corrective legislation which would move the insurable event to bankruptcy or liquidation of the sponsoring employer. It is recommended to cut back on the premium and deal with the legislative issue separately.

In summary, the request by the PBGC for a \$7 premium level is unreasonable with respect to the length of time used for eliminating the deficit and suspected to be unreasonable with regard to the underlying assumptions used in developing anticipated future claim figures.

The American Retail Federation strongly urges a lesser premium based upon use of an extended amortization and a claim that no premium justification can be accepted until the basis for such is available for comment by the affected employers.

KOHLER Co.,

Kohler, Wis., March 28, 1984.

Mr. JOHN J. SALMON,

Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: The House Committee on Ways and Means is currently considering reforms to the single employer plan termination insurance program and an increase in the premium from \$2.60 per participant to \$7.00 per participant.

We support the reform of the program but strongly urge the committee to resist the premium increase.

There are two methods for an employer to approach the provision of sufficient income security at retirement for its employees. The employer can develop a defined contribution pension plan in which the risk of having sufficient retirement income is on the employee or the employer can offer a defined benefit plan where the risk of providing sufficient retirement income is on the employer. From the standpoint of public policy, the best choice is obvious—the creation of defined benefit plans should be encouraged. However, just the opposite is going to take place with a 169% increase in the PBGC premium.

As employers look at that kind of an increase, and believe me they will see this one, there will be some very serious soul searching about the value of their defined benefit plans. There will be a strong incentive to terminate defined benefit plans, exacerbating the PBGC's funding deficiency, and very few new pension plans will be of the defined benefit type. There will be a definite move away from defined benefit plans which we cannot believe is in the public interest.

Our recommendation for the PBGC's current predicament is to tighten the rules for plan terminations and to allow a longer amortization period for the current deficit.

Sincerely,

DANIEL A. DEBAKER,

Manager-Employee Benefits.

STATEMENT OF PHYLLIS SPIELMAN, WHITE BEAR LAKE, MINN.

The central concern of the committee hearing held on March 20, 1984 on H.R. 3930 focused on the increase in premiums to support the pension insurance system administered by the Pension Benefit Guaranty Corporation, a government agency. Those premiums under the bill would rise from \$2.50 to \$7.00 per plan participant per year.

Since I do not have the latest financial reports of the Pension Benefit Guaranty Corporation (PBGC) and its possible exposure to future plan terminations, I will forgo comment in that area. However, I do wish to address several portions of H.R. 3930 which raise some specific concerns which I feel I must address at this time. My

experience in the field of pension law, both as former administrator of the Pension Protection Division of the Minnesota Department of Labor and Industry and as a member and chairperson of the PBGC Advisory Committee, has given me firsthand knowledge of the operation of the Employee Retirement Income Security Act of 1974 (ERISA) and its immediate effect on plan participants, those whom Congress sought to protect from the pension system abuses when it passed that historic legislation. It is from that experience that I feel compelled to comment on several problems evident in H.R. 3930.

First is the proposal to allow plans to terminate at will with only a plan administrator's supposed verification, instead of close PBGC examination as in current law. Such a change would open up the system to abuse of participant rights and entitlements, leaving many bereft of their pensions, with PBGC virtually powerless to recapture those pension monies from the terminated plan.

Part of that same problem is that allowing plans to terminate at will encourages terminations which result in raiding the pension funds for short-term corporate purposes. This raiding is done when an employer claims the plan is "overfunded", when what actually happens is that large numbers of employees have been terminated in a period of a business turn-down, many of whom are not vested but their pension accruals remain in the fund. So the employer decides he can pick up a considerable amount these accruals by terminating the plan, even though there is no overriding financial crisis that might demand such action. The employer seeks the "windfall profits" of this type of termination.

In other cases, a pension plan's vesting requirements may not reflect the normal employee turnover rate, so again the employer seeks the "windfall profits" that can be his by terminating the plan whenever the pot appears full enough to make it worth the effort.

Present ERISA law provides that when length of service required for vesting is abnormally greater than the turnover rate, IRS is empowered to disqualify the plan or require vesting which reflects the actual turnover rate.

I would suggest this area of ERISA be strengthened so that plans are not subject to such unfair corporate raiding. Further, that government agencies which have enforcement powers, even under current law, be held accountable and be monitored for their performance in this area. I have yet to hear or read that IRS has required a plan to change its vesting requirements to reflect its actual turnover rate. If it had done so, I suggest that the A&P plan probably would not have been able to lay claim to the \$200 million in so-called surplus funding of the plan.

Even in instances like the A&P termination, IRS Code, section 411(d)(3) incorporated into ERISA provides for full vesting of accrued benefits, to the extent funded, upon termination or partial termination of a plan. That section also provides that if a large number of employees are discharged during a period of economic decline by a company, that a partial termination may occur which also would require that employees so discharged would be fully vested in their accrued benefit, regardless of their years of service. Strict enforcement of this section is needed to prevent raiding of funds for corporate gain at the expense of plan participants.

Specifically relating to the PBGC Advisory Committee, I would urge the following changes:

1. That meetings of the Advisory Committee be required to be held as open public meetings, and that all proposed regulations drafted by PBGC staff and all other matters that have normally come before the committee since its inception continue as required agenda for such meetings.

2. That the current Advisory Committee of seven be expanded to at least nine members, and that those two additional members shall be representatives of retirees.

In my capacity as former chairperson and member of the PBGC Advisory Committee, I became vividly aware that had some of the proposed regulations been discussed in open meetings since the committee's inception, the final regulations adopted would probably have been more in line with Congressional intent. At least open meetings would have created more public discussion on critical issues which became buried in the "legaleze" of the Federal Register, to which few persons or groups have ready access.

Open meetings insure the public's right to know and prevents an unseen and silent body from changing or modifying legislation, through its power to draft and administer regulations, in a manner which at times may violate the intent of Congress.

Congressional committees hold public hearings to discuss proposed legislation. Why then should we require less of the agencies empowered to develop regulations to implement legislation?

I might add that the Advisory Council on Employee Welfare and Pension Benefit Plans, also created by ERISA, holds public meetings, though there have been repeated attempts to close them. I would urge that all advisory committees pertaining to ERISA be required to hold public meetings.

In recommending expansion of the PBGC Advisory Committee to nine members, I do so with the realization that the interests of current plan participants and those who manage pension plans are sometimes not the interests of retirees. In striking a balance of fairness, retiree interests should also be represented.

I would urgently recommend these changes be incorporated into H.R. 3930.

Thank you for the opportunity to express these concerns to the House Ways and Means Committee at this time.

